



तमसो मा ज्योतिर्गमय

SANTINIKETAN
VISWA BHARATI
LIBRARY

336

W 77

OUR MONEY AND THE STATE

BY THE SAME AUTHOR

STOCKS AND SHARES

4th Impression. 7s. 6d. net

**MONEY CHANGING : An Introduction
to Foreign Exchange**

3rd Edition. 3s. 6d. net

THE MEANING OF MONEY

15th Impression. 3s. 6d. net

POVERTY AND WASTE

3s. 6d. net

WAR AND LOMBARD STREET

3rd Edition. 3s. 6d. net

INTERNATIONAL FINANCE

3s. 6d. net

OUR MONEY AND THE STATE

BY HARTLEY WITHERS

Life is like playing a violin solo in public
and learning the instrument as one goes on.

SAMUEL BUTLER. *Essays on Life, Art and Science*

LONDO
JOHN MURRAY, ALBEMARLE STREET, W.
1917

ALL RIGHTS RESERVED

P R E F A C E

THIS book grew out of a course of lectures on Public Finance delivered at the London School of Economics in February and March. The subject had already been dealt with ably and fully by writers who had made a special study of it; but the present war, by making us spend with such Titanic recklessness, has supplied us with a huge magnifying glass, by which cause and effect are more clearly seen than in times of peace. The results of borrowing, inflation of currency, and inequities in taxation are seen at work now on such a scale that if we use the experiences of the war aright, they may help us to better financial methods when the war is over. Students who wish to pursue the subject into its technical and scientific details can do so with the help of *Public Finance*, by Prof. Bastable; *The Income Tax* and other works on taxation by Prof. Edwin R. A. Seligman; *British Budgets, 1887-1913*, by Sir Bernard Mallet; *The System of National Finance*, by Mr. E. Hilton Young, M.P.; *The Financial System of the United Kingdom*, by H. Higgs, C.B.; and that monument of industry and mine of statistical and other information, the House

of Commons Return (366) of 1869, on Public Income and Expenditure, etc., drawn up by Henry W. Chisholm, sometime Chief Clerk of the Exchequer: it is commonly called *Chisholm's Analysis of the Public Accounts*, 1688-1869.

HARTLEY WITHERS.

6, LINDEN GARDENS,
June 1917.

CONTENTS

CHAPTER I

	PAGE
THE OBJECTS OF GOVERNMENTAL SPENDING .	I

Government spends to secure property of citizens, to defend national honour, to increase country's material resources and promote national health—Government's theoretical right to take all citizens' property modified by practical inability—Change in view as to governmental activity—Spencer—Huxley—Adam Smith.

CHAPTER II

MONEY TAKEN BY BORROWING	25
----------------------------------	----

Borrowing popular owing to belief that it makes posterity pay—This belief delusive—War paid for while it goes on—Borrowing only affects distribution of posterity's income—Borrowing at home—Its drawbacks—Borrowing abroad.

CHAPTER III

MONEY WATERED BY INFLATION	52
------------------------------------	----

Medieval debasement of currency—Modern inflation—Methods by which currency is increased—Why it happens—Evil effects.

CHAPTER IV

	PAGE
MONEY TAKEN BY TAXES	73

Does money left with citizens always "fructify"?—
 Adam Smith's maxims—Walker's criticism—Gradu-
 ation and differentiation—The ideal income tax—
 Unfairness of indirect taxes—Import duties.

CHAPTER V

THE LIMITS OF GOVERNMENTAL SPENDING	105
---	-----

Can the State earn revenue by trade enterprise?—
 Fabian scheme—Imperial Committee's proposal—
 Adverse experiences—Limits to taxation—Willing-
 ness of taxpayers essential.

OUR MONEY AND THE STATE

CHAPTER I

THE OBJECTS OF GOVERNMENTAL SPENDING

WHY does the Government take our money? Because government costs money, and cannot be had without it. Taxation is the price that we pay for government and protection. Most of us do not want, or need, to be governed ourselves. Respect for law, or for the duties and customs that law embodies, is so engrained in us by centuries of tradition, that the presence of the policeman on his beat is a fact that never influences our conduct. But if we do not need to be governed ourselves, we very much need other people to be governed and prevented from attacking us or our belongings. Protection of our persons and property, from home and foreign foes, is the first and most important business of government; and the chief reason that it can give if we ask it "Why should we pay taxes?" is this: "Because, if you don't, you will be in danger of losing everything that you have got."

Government does so much in these days besides its first elementary task of protecting us from one

another and from outward foes, that we are apt to forget that this is its original business. But as the point is very important, as we shall see later, it is well to get it fixed into our heads by reading the plain words in which it is set forth by John Locke. In Chapter I of his *Essay concerning the True Original Extent and End of Civil Government* he says :

“ Political Power then I take to be a Right of making Laws with Penalties of Death, and consequently all less Penalties, for the regulating and preserving of Property, and of employing the Force of the Community in the Execution of such Laws, and in the Defence of the Commonwealth from Foreign Injury, and all this only for the Publick Good.”

In Chapter VIII of the same Essay we find :

“ The only Way whereby anyone divests himself of his natural Liberty and puts on the Bonds of civil Society, is by agreeing with other men to join and unite into a Community, for their comfortable, safe, and peaceable living amongst one another, in a secure Enjoyment of their Properties, and a greater Security against any that are not of it.”

And in Chapter IX the matter is summed up thus :

“ The great and *chief End* therefore, of Mens uniting into Commonwealths and putting themselves under Government, is the *Preservation of their Property.*”

Locke did not leave the object of government on

this merely businesslike foundation. He did not really mean that we only submit to being governed in order that we may grow rich and fat and enjoy our riches without fear of burglars or marauding foes. He says in another passage that the End of Government is the Good of Mankind. This is a more inspiring ideal, but we shall all acknowledge that it cannot be secured unless man's material wants are satisfied, and that as society is at present constituted, this cannot be done unless property is protected. Some day mankind will perhaps grow into a race of beings who will work for the pleasure of working, and not mind who takes and uses the stuff that they make and grow. There are already many more of such people than old-fashioned economists admit. But in considering present-day problems, we have to take human nature as it is, and nations cannot at present increase their wealth, and so their power to secure the Good of Mankind, unless those who increase it are secured in the enjoyment of it.

Protection of the property of the citizens being thus the original, and still a very important, duty of the State, it follows that the State, in order to carry it out, can make any claims that it pleases on the services and property of the citizens. The State, as Professor Bastable tells us, "is entitled to claim all the services and property of its subjects for the accomplishment of whatever aims it prescribes to itself. When stated in so rigid a form," he adds, "the proposition is likely to awaken dis-

sent, and yet, from the strictly legal and administrative point of view, it is a commonplace since the time of Austin." ¹ (Austin was a great authority on law, who lived and wrote in the first half of the nineteenth century.) It is true enough, as Professor Bastable suggests, that the average British pater-familias may be startled into an indignant denial of the great law that the State has a right to take all his work and all his goods. But a few moments' thought would convince him that the proposition is quite sound in logic, since the State cannot do its business if all the citizens are to be able to decide how much, or how little, they are to give, in work or in goods, to its support ; and he would also comfort himself with the reflection that, however logical be this power of the State, it cannot be exercised beyond a certain point. On paper, the State may be able to set us all to work for it, but it cannot make us work hard or well unless we are willing to do so. On paper, the State may be able to take all our property, but if it did, then it would not be worth anyone's while to get property. The citizens would cease to accumulate property, that is, to leave the world richer than they found it. Either the State would have to accumulate on its own account, which it could only do if the citizens were willing to work for it, or it would find that it had come to a standstill.

Professor Bastable's proposition, though absolutely true as a principle, is thus modified by the

¹ *Public Finance*, p. 42.

very real power of the citizen to refuse to produce either the work or the property that the State has the power to take. This power of the overtaxed citizen to strike effectively against taxation is no fanciful suggestion of what might possibly happen. It has happened. Under the Roman Empire taxation was enormously heavy, for the support of the Army, the Imperial Court, and "the great number of clerks made necessary by the bureaucratic form of government." It was also extremely oppressive, since the senatorial class, the Army, Professors of Rhetoric, and the Clergy, were largely freed from it, and so the whole burden fell on the curials, that is, owners of twenty-five acres of land, or its equivalent.

"When the curials were bankrupt and could no longer pay the taxes, they attempted in every way to escape from their class. Some of them succeeded in rising into the senatorial ranks; many of them deserted their lands and became slaves, or entered the Army or the Church. The Emperors, trying to prevent this, often seized the curial who had run away and compelled him to take up his old burden again."¹

This fact, of the taxpayers' power to strike, is very relevant to modern problems of finance, because it may come into play long before there is any question of the State's taking the whole of our goods. As soon as the pressure of taxation begins to be heavy, the danger has to be ever present in

¹ *A General History of Europe (350-1900)*, by Thatcher and Schwill, pp. 9-10.

the mind of the Chancellor of the Exchequer, that he may, by his present exactions, be preventing the future growth of the country's wealth, and so making the task of his successors difficult, if not impossible. Taxation that is resented, beyond a certain point, will be evaded or avoided. The tax-gatherer can only work to his own satisfaction if he carries the sense of the taxpayers with him. Hence it is of the utmost importance, not only that our rulers should tax well, but that the citizens should understand about taxation, recognize it as good when it is good, and pay it cheerfully when it is equitable and well distributed.

"All taxes are confiscation," said Mr. Joseph Hume in the House of Commons in 1833.¹ In the original sense of the word confiscation, which meant "putting into the Treasury," this is clearly a platitude. But as it now is generally taken to mean an arbitrary appropriation, these words sum up a fallacy about taxation which has to be exorcised and expelled before the fiscal arrangements of this or any other nation can be comfortable either for the taxpayer or the taxed. In fact, taxation is, or ought to be, the process by which the State takes money from us, in proportion to our ability to pay, to spend on the defence of our property from home or foreign enemies, on the defence of the national honour, if need be, on the increase of the material and other resources of the country, and on the public health.

If this be a true description of taxation, taxation

¹ Seligman, *The Income Tax*, p. 122.

is a process to which we must all submit gladly. All the objects for which the money so taken from us, with one exception, will literally pay us, if they are carried out. That exception is the defence of the national honour, and he would be a craven skinflint who would grudge money well spent on that. Defence of our property clearly pays us. So does the increase of the country's resources, because it will make the burden of taxation lighter. If our particular income does not increase, but that of others does, and if taxation is taken in proportion to our ability to pay, we shall have to pay less in proportion. Public health pays us because it lessens infectious and contagious disease, and so keeps down our doctors' bills.

But if this description of taxation be untrue, it is our business to make it true, and this can only be done if everybody gives careful thought to the matter, so that if our rulers make mistakes, there shall be a strong body of well-informed opinion to criticize and correct them; and also so that we may learn that it is not the object of every citizen to pay as little in taxes as possible, because if that spirit is abroad, the fiscal machinery of the country will never run smoothly and well; we have to learn to judge whether taxes are fair from the point of view of the nation as a whole, and when we recognize them as fair, to pay them gladly and readily. In time of war this readiness to pay is produced, sometimes, by patriotic enthusiasm. In the early days of the present war, taxpayers wrote

to the Chancellor of the Exchequer expressing the pleasure with which they paid income tax. If we could be sure that money taken in taxes was taken fairly, and used well for the national benefit, that pleasure ought at all times to be present when we pay it.

It has been said that a nation gets the Government that it deserves, and Public Finance is certainly a department in which the pressure of enlightened public opinion can do much. But we shall never learn to get our Public Finance on a sound and businesslike basis until we understand our own domestic expenditure better. When we recognize the responsibility that is attached to the use of our own money, we shall be able to begin to see that our rulers make good use of the money of the nation. As long as there is a common tendency among the citizens to waste their incomes on fripperies and vulgarities in obedience to fashion and convention, and to invest their savings in wild-cat speculations in the hope of getting wealth without trouble, we need not expect the national finances to be as well husbanded as they might be. The sum of the national wisdom, in finance as in other things, may be a little greater than the aggregate wisdom of all the citizens, but cannot lead it by much.

Going back to our description of what taxation is, or ought to be, we see at once that even if everyone were to agree to it as stated, there are several expressions in it about which agreement is not

likely to be reached as long as the present framework of society stands. In the first place, the question of ability to pay is full of pitfalls and difficulties which will be discussed in a later chapter. First of all, we have to try to get something like a clear conclusion about the objects on which the State is entitled to spend our money, when it has taken it, and on this there has been, is, and always will be, a good deal of divergence of opinion. As stated above, and with reservations and restrictions to be noted later, I venture to think that, in these days, most taxpayers would give at least a hesitating and guarded consent to the scope of State expenditure. But there was a time when it would have been thought to be much too wide, and many people now will think it much too narrow. The *via media* is a dull and unromantic path, but it has a certain safety.

Herbert Spencer may be taken as an extreme example of those who would limit the spending of the State. To him it seemed that the State should spend nothing except on public justice and defence. He was the uncompromising apostle of personal freedom, and he believed that only through it could progress and development, of the individual and of the nation, best be achieved. He had an unconquerable objection to anything like discipline or government, so strong that, when a lad of thirteen, he walked home from Bath to Derby rather than stay at school. He walked forty-eight miles in one day, forty-seven on the second, and twenty-five on

the third, without sleep, and with very little food.¹ In his youth he did not even admit that the Government should spend money on external defence. Either he believed that a mercenary army and navy, hired by private subscription, would suffice to keep out enemies, or else he took the extreme pacifist view that an unarmed nation need not fear attack. But, in his later years, he abandoned this view, and admitted national defence as a proper object of government expenditure. He still, however, thought that the Postal Service would have been much more cheaply and efficiently managed if it had been left to private enterprise, which is quite possibly true, though it is hardly likely that postal facilities would have been so well distributed. He "advanced the doctrine that, as we trust the grocer to furnish us with pounds of tea, and the baker to send us loaves of bread, so we might trust Heaton & Sons or some of the other enterprising firms of Birmingham to supply us with sovereigns and shillings at their own risk and profit."² He even contended that sanitation was not a proper object of collective activity, and records with obvious pleasure how the early efforts at drainage, being defective, sometimes produced disease. It need not be said that education was a matter which every citizen should, and could best, provide for himself or his children. He is never tired of laughing at our belief in the power of the State to do anything.

¹ *Herbert Spencer*, by Hugh Elliot.

² *Money and the Mechanism of Exchange*, Jevons, p. 64.

“Conceiving [he says], the State-agency, as though it were something more than a cluster of men (a few clever, many ordinary, and some decidedly stupid), we ascribe to it marvellous powers of doing multitudinous things which men otherwise clustered are unable to do. We petition it to procure for us in some way which we do not doubt it can find, benefits of all orders ; and pray it with unfaltering faith to secure us from every fresh evil. Time after time our hopes are balked. The good is not obtained, or something bad comes along with it ; the evil is not cured, or some other evil as great or greater is produced. . . . This emotion which is excited by the forms of governmental power, and makes governmental power possible, is the root of a faith that springs up afresh however often cut down. To see how little the perennial confidence it generates is diminished by perennial disappointment, we need but remind ourselves of a few State performances in the chief State Departments.”¹

He then proceeds to give several examples of administrative ineptitude, the most tragical and absurd, perhaps, of which was the fact that it took two centuries (1593 to 1795) for the Admiralty to adopt the use of lemon-juice as a protection for the crews of our warships against scurvy.

“And what [he asks] has been the effect of this amazing perversity of officialism ? The mortality from scurvy during this long period had exceeded the mortality by battles, wrecks, and all casualties of sea-life put together ! ”

¹ *Study of Sociology*, ch. vii. p. 160.

Such an example of a waste of gallant lives by the imperviousness of the official mind to new ideas goes a long way towards proving Spencer's contention that Governments, or some Governments, are not as capable as private individuals or companies of doing anything which can, on other grounds, be left to the latter. And we need not turn back over the pages of ancient history to find such examples of departmental fatuity. During this very war there have been plenty of them, though we may hope that loss of the lives of our fighters has not been thus criminally involved.

But when all this is admitted, there are still several things to be said on the other side of the question. A nation in which governmental action has long been restricted and resented must not complain too loudly if the Government, when it is suddenly told to do things, does them badly. In countries where a trained bureaucracy has long been encouraged to do much, its efforts are likely to compare better with those of private enterprise. The efficiency of the German governmental machine is probably much exaggerated ; but anyone who travelled on the German State-owned railways had no reason to complain of their comfort or of their punctuality. In those respects they seemed to me, from a certainly very limited experience, to compare well with our own much-vaunted railway system, which, in some respects, was unquestionably a disgrace to private enterprise. Anyone who travelled much on Sundays on the suburban lines of our leading railways

cannot have failed to marvel at the utter contempt for public convenience with which they conducted their service. They stimulated the public desire to travel by cheap tickets—I am speaking, of course, of days before the war—but made no attempt to provide accommodation for it; a few slow trains, disgracefully unpunctual and more disgracefully overcrowded, were the only means afforded to jaded Londoners who sought for a few hours of fresh air on the day of rest. Why the public submitted to it was a mystery. If the railways had then been in the hands of the Government there would have been a clamorous outcry against mismanagement by jacks-in-office. As it was companies—"with no body to be kicked, or soul to be damned"—that were at fault, there was never a murmur. In America, that other home of individual enterprise, the unpunctuality of the railroads is often astonishing. I once travelled—it is some years ago—from Pittsburg to New York on Christmas Eve. The locomotive was attacked by a malady called "hot box" and the train was four hours late. It was full of unfortunate holiday-makers who had connections to make in New York, so as to get home in time for the Christmas gathering, but they all seemed to accept it as something in the nature of things, and not a matter that called for protest or complaint.

We had better admit that in this half-baked world of ours, in which progress is only at the beginning of its journey, and man is only just beginning to learn the use of his powers over Nature, not many

things are yet very well done either by Governments or by private enterprise, and the only way for them to get done better is by every one of us trying to do his own little job just as well as ever he can. In some countries Governments do things better than anybody else. In others, it is otherwise. Here it is safe to say that Government has not yet distinguished itself as a practical worker. It has done great things in the war, but chiefly with the help of men who came in from outside ; and whether the public's experience of governmental activity during the war will, or will not, encourage it to give Government more to do when the war is over, is a very open question.

Moreover, even if Herbert Spencer's view of the ineptitude of governmental action were as completely proved as he believed, there are still some things which have to be done by a public authority, as even he would probably have admitted if he had lived to this day. His notion of private companies competing for the business of draining our towns, and only cleansing those neighbourhoods in which they could get enough customers to make it worth their while, is now commonly recognized as a fantastic example of overdriving a principle. Huxley, in his great *Essay on Administrative Nihilism*, attacks the Spencerian position in the following well-known passage :

“ Suppose, however, for the sake of argument, that we accept the proposition that the functions of the

State may be properly summed up in the one great negative commandment, 'Thou shalt not allow any man to interfere with the liberty of any other man'—I am unable to see that the logical consequence is any such restriction of the power of Government as its supporters imply. If my next-door-neighbour chooses to have his drains in such a state as to create a poisonous atmosphere, which I breathe at the risk of typhus and diphtheria, he restricts my just freedom to live just as much as if he went about with a pistol, threatening my life; if he is to be allowed to let his children go unvaccinated, he might as well be allowed to leave strychnine lozenges about in the way of mine; and if he brings them up untaught and untrained to earn their living, he is doing his best to restrict my freedom, by increasing the burden of taxation for the support of gaols and workhouses, which I have to pay." ¹

Since the days when these two giants threw mountains of arguments at one another, it need not be said that Huxley's view has prevailed, and more than prevailed. It has wiped out the Spencerian doctrine, and it has been carried to lengths which Huxley himself might well consider absurd if he were still alive. The popular cry is now for the Government to do everything. An extraordinary example, as it happens, is chronicled in the paper of this day on which I am writing, Sunday, February 18th, 1917. To-day's *Observer* records how—

"at a meeting of the Southend Townsmen's Association it was suggested that the Minister of Labour

¹ *Critiques and Addresses*, p. 10.

should be asked to encourage the production of food by the closing of the churches on Sunday morning, and so enabling a greater amount of labour to be available. The suggestion had reference to the large number of Southend business men and clerks who are away from home all the week, and have only Sunday mornings on which to look after their gardens."

This astonishing paragraph was headed "Churchgoers' Neglected Gardens," and seems to indicate an extraordinary state of mind prevalent in a suburb inhabited by people who may be taken as average specimens of the dwellers in Greater London. Because people work all through the week, and can only dig in their gardens on Sundays, it is proposed, in order to enable them to do so, to get the Minister of Labour to close the churches. In a land that calls itself free and is engaged in a great battle for freedom, it is really astounding that a body of Southend citizens should have seriously thought (1) that as long as the churches were open, their frequenters had no freedom of choice about staying in their gardens and growing food, and (2) that it was the business of the Government to help them to do so by depriving all the other members of the various congregations, who have all the week to dig in, of their freedom to seek ghostly consolation by attending divine worship.

It is easy to make too much of a wild example of this kind. Southend is not England, and probably the Townsmen's Association is not Southend.

In war-time the babbling busybody gets a chance, in associations and on committees, such as he never enjoyed before. But it will hardly be denied that this is only an extreme example of a tendency that is rife. It is high time that we considered this tendency seriously and reckoned its possible effects, if it goes unchecked, on the Government's spending in the future. It need hardly be pointed out that the spread of governmental activity is bound to increase the cost of government, since everything that the Government does costs money, usually more than it would if it were done by private individuals or bodies managed thereby. It is very evident that the present tendency to leave everything to Government is due partly to the war, because war on its present scale demands something like dictatorship, and when it is necessary for victory that the whole resources of a nation shall be made available for purposes of defence, individual freedom takes a very different place in the scale of importance. So far, there is good reason for this tendency. But it was also very rife before the war, and was even then showing signs of running to extremes. This was natural and inevitable, because it was only a reaction against the extreme *laissez-faire* or "leave-people-alone" policy, of which Herbert Spencer was perhaps the doughtiest champion.

This policy had been dominant in England in the early part of the nineteenth century. It was well summed up in the report of a Commission appointed

by the House of Commons in 1810, quoted in Mr. and Mrs. Webb's *History of Trade Unionism*, as follows :

“ No interference of the legislature with the freedom of trade, or with the perfect liberty of every individual to dispose of his time and of his labour in the way and on the terms which he may judge most conducive to his own interest, can take place without violating general principles of the first importance to the prosperity and happiness of the community.”

Such was the view that was maintained by the economists who followed Adam Smith and carried much further than he did the revolt that he had led against the excessive interference by Government with trade and with the freedom of individual contract, which had marked the history of the earlier centuries when, for example, justices of the peace fixed wages, or tried to. Supporters of the extreme *laissez-faire* school based their doctrine on the assumption—so true in an ideal world composed of ideally educated people, so pathetically untrue as things are—that everybody is the best judge of his own interest, and that if everyone is left to pursue his own interest, the best interest of the community as a whole will somehow be secured. The practical result of the application of this doctrine, in a community in which employers had been taught that they served the common good by pursuing their own immediate interests, and the employed had often been taught nothing, was

that children of five years were sent to work in factories, and in France, according to a report published in 1840 by Dr. Villermé, "the thong used for the punishment of children in the spinners' trade appears as an instrument of production."¹ The fact is, that very few of us ever know what is best to do for our interest. Most people go through life mechanically, and without thinking about it, choosing a profession for some quite illogical reason, or being pitchforked into a position without attempting to weigh it against other possibilities. Moreover, we are obliged to make up our minds about the matter, in most cases, long before we have got a mind to make up. As for the doctrine that each man by pursuing his own interest helps to secure the common good, its truth is pleasantly illustrated by the millions nowadays earned by sellers of worthless medicines and printed trash, which rot the public stomach, bodily and mental. If the economists of the nineteenth century had foreseen the activities and success of the advertisers of the twentieth, they might have modified their optimism.

But there is no need to linger over the absurdities thought and written by the extremists of the *laissez-faire* school. Peace with their ashes, for they did a great work in clearing away a mass of rubbish. It was not their fault that thongs were laid in the name of liberty on the backs of bairns who ought

¹ Quoted by Messrs. Gide and Rist, *History of Economic Doctrines*.

to have been playing hopscotch. Liberty is a goddess with many shapes, looking quite different to different observers. Abraham Lincoln observed that—

“with some, the word liberty may mean for each man to do as he pleases with himself and the product of his labour; while with others, the same word may mean for some men to do as they please with other men, and the product of other men’s labour. . . . The shepherd drives the wolf from the sheep’s throat, for which the sheep thanks the shepherd as his liberator, while the wolf denounces him for the same act, as the destroyer of liberty, especially as the sheep was a black one.”¹

It has already been noted that the extreme limits imposed on Government activity and consequently on governmental expenditure, by Herbert Spencer and the economists who followed Adam Smith, were an exaggeration of the doctrine laid down by Adam Smith. He took a much more level-headed view of the matter. In his examination (in Chapter I, Book V, of the *Wealth of Nations*) of the expenses of the Sovereign or Commonwealth, he lays stress on his or its duty—

“of erecting and maintaining those public institutions, and those public works which, though they may be in the highest degree advantageous to a great society, are, however, of such a nature, that the profit could never repay the expence to any individual, or small number of individuals, and

¹ Speech at Baltimore, April 18th, 1864.

which it therefore cannot be expected that any individual, or small number of individuals, should erect or maintain."

Thus, in effect, he gives a free hand to the State to spend money on anything that will be advantageous to society, but will not yield a profit.

With regard to education, Adam Smith arrives at conclusions which were diametrically opposed to those of Herbert Spencer. He points out that in cases in which the state of the society does not place—

"the greater part of individuals in such situations as naturally form in them, without any attention of Government, almost all the abilities and virtues which that state requires, or perhaps can admit of," then—

"some attention of Government is necessary in order to prevent the almost entire corruption and degeneracy of the great body of the people."

He goes on to show that, owing to the division of labour—

"the man whose whole life is spent in performing a few simple operations . . . has no occasion to exert his understanding. . . . His dexterity at his own particular trade seems, in this manner, to be acquired at the expense of his intellectual, social, and martial virtues. But in every improved and civilized society, this is the state into which the labouring poor, that is, the great body of the people, must necessarily fall, unless Government takes some pains to prevent it."

A little later he shows that—

“ the common people . . . have little time to spare for education. The parents can scarce afford to maintain them even in infancy. As soon as they are able to work, they must apply themselves to some trade by which they can earn their subsistence. That trade too is generally so simple and uniform as to give little exercise to the understanding ; while, at the same time, their labour is both so constant and so severe that it leaves them little leisure and less inclination to apply to, or even think of, anything else. . . . For a very small expense the public can facilitate, can encourage, and can even impose upon almost the whole body of the people, the necessity of acquiring those most essential parts of education.”

Here we have the Father of Economics, so often appealed to, by those who do not read him, as an out-and-out champion of *laissez faire*, advocating compulsory education, at the public expense, nearly one hundred years before it was introduced in England.

It is perhaps even more interesting in these war-like days to note that Adam Smith thought that—

“ even though the martial spirit of the people were of no use towards the defence of the society, yet to prevent that sort of mental mutilation, deformity and wretchedness, which cowardice necessarily involves in it, from spreading themselves through the great body of the people, would still deserve the most serious attention of Government ; in the same manner as it would deserve its most serious

attention to prevent a leprosy or any other loathsome and offensive disease, though neither mortal nor dangerous, from spreading itself among them. . . . The same thing may be said of the gross ignorance and stupidity which, in a civilised society, seems so frequently to benumb the understandings of all the inferior ranks of people. [Only the "inferior" ranks, Doctor?] The more they are instructed, the less liable they are to the delusions of enthusiasm and superstition which, among ignorant nations, frequently occasion the most dreadful disorders. . . . In free countries where the safety of government depends very much upon the favourable judgment which the people may form of its conduct, it must surely be of the highest importance that they should not be disposed to judge rashly or capriciously concerning it."

I have dwelt at some length on ancient controversies concerning the limits of State action and consequently of State expenditure, because the question is a very burning one to-day, and if we see what our forbears thought about it, we may be helped to a right decision in our present difficulties. We have seen the extreme view that the State should do nothing but police and defence give way to a tendency—even among those who do not profess to be Socialists and to want the State to take over the whole business of production and distribution—to call on the State to interfere constantly in the private affairs of citizens; and looking back to the doctrine of Adam Smith, we find that he was in favour of State expenditure on education for

those who could not afford it, on the cultivation of the martial spirit, on checking disease, and on the enlightenment of those classes which, in his opinion, especially needed it. I think it may fairly be claimed that the formula adopted earlier in this chapter may be taken as representing a safe compromise between the extreme views: that is, that the State should spend our money on the defence of our property from home and foreign enemies, on the defence of the national honour, on the increase of the material resources of the country, and on public health. At first sight, this formula would not appear to include education, old-age pensions, or unemployment insurance. But it would be very easy to show that all these objects of expenditure help the increase of the material resources of the country, to which nothing can be more important than a well-taught community, and a working class with a feeling of security and a knowledge that the State cares for its interests, and is prepared to spend money on its welfare. In fact, all really effective measures of social reform are directly beneficial to the whole community, on the coldest business considerations. Every man and woman who is not fit in mind and body to be self-supporting has to be supported, to a greater or less extent, by his or her neighbours; and so government spending that lessens the number of the unfit, by better care for the minds and bodies of those who are born into conditions which do not give them a fair chance, is a sound investment.

CHAPTER II

MONEY TAKEN BY BORROWING ¹

WHATEVER be the duties that a Government is asked to fulfil, it can only perform them by taking to its own use such goods and services as are needed for them. To keep order at home it must have the services of policemen and the goods needed to feed, clothe, and equip them. To build a railway it must have steel rails, rolling stock, and land and the services of all the people who lay the railway out and get it ready for working. To carry on war it must have all the goods needed for the feeding and equipment of an army and the services of the fighters and of those who organize and manage the campaign, the transport service, and all the other items in the problem. These goods and services have to be supplied out of current production at home and abroad, and so current production has to be diverted, to the extent of the Government's demand, to supplying those needs, unless (which is unlikely in time of war) it can be increased suffi-

¹ Since this chapter was written I have been fortified by seeing its main contention endorsed by Professor Sprague, of Harvard, in an article in *The Economic Journal* for April 1917, which embodied an address given by him to the American Economic Association.

ciently to produce them without this diversion. In order to bring about this diversion, Government has to check the demand of individuals for goods and services so that labour and energy may be set free to work for it ; and this it does by taking money from individuals in taxes, which it can only impose on its own citizens, or in loans, or by reducing the buying power of individuals through the process known as inflation, which consists of unduly increasing the volume of the currency and so debasing its value and raising prices.

We will begin with the borrowing process. When a Government borrows, it invites people to lend it money, and, as a rule, promises to pay them a certain rate of interest for it, and sometimes promises to pay back the money to them or their heirs and assigns at some more or less distant date. Even when no such promise of repayment is given to the lenders, the fact that the holder of the security, or promise to pay interest, can always sell it at a price on the Stock Exchange,^c enables him to rely on getting back at least part of the money that he has lent, if he wishes to do so.

It was stated that when a Government borrows it promises, as a rule, to pay interest. This is now so usual that a loan without interest seems to a modern mind to be almost a contradiction in terms. But such things have happened. In the good old days impecunious sovereigns who could not get as much as they wanted out of their subjects by taxation, used to write to people of property and

demand a sum from them on loan ; the latest example of this form of finance occurred in the early years of the reign of James I. A large number of these letters—which were called Letters of Privy Seal—dated July 31st, 1604, were sent to the principal noblemen and gentlemen in all the counties of England, and excited great and general dissatisfaction. Their form was as follows :

“ BY THE KING :

“ Trustie and well beloved we greete you well. Although there be nothing more against our minde than to be drawne into any course that may breed in our subjects the least doubt of our unwillingness to throw any burthen upon them, having already published both by our speeches and writings, our great desire to avoide it in the whole course of our Government : Yet such is our estate at this time in regarde of great and urgent occasions falne and growing daily upon us, (in no sort to be eschewed) as wee shall be forced presently to disburse greater summes of money than it is possible for us to provide by any ordinary means, or to want without great prejudice, in which consideration . . . we think it needless to use any more arguments from such a King to such subjects : But that as our necessitie is the only cause of our request, so your love and ducty must be the chiefe motive of your ready performance of the same . . . That which we require, therefore, is that within twelve dayes after the receipt hereof, you will cause the summe of _____ to be delivered to _____ whom we have appointed to be our collector in our countie of _____

“The loan whereof we do desire to be untill the Foure and Twenty day of March which shall be in the yeere of our Lord God 1605, for assurance whereof we have directed these our letters of Privie Seale unto you, which, with the hand of our sayd collector testyfyng the receipt of the same summe of . . . shall bind us, our heirs, and successors for the repaiment thereof . . . upon the deliverie of this our Privie Seale unto our sayd receipt.”¹

Through all the rambling verbiage of this Letter of Privy Seal, a large part of which has been left out, there is no whisper or hint of any interest payment. The loan was for nearly eight months, and from its terms was evidently a requisition, leaving the receiver of the letter little or no choice about producing the sum required of him.

In modern times, however, these things do not happen. A rate of interest is universal, and a definite promise of repayment is very usual. It is notably absent, however, in the case of our own Government's Consols. The holder of Consols has no right to repayment from the Government, only the right to a perpetual annuity of so much a year, originally 3%, converted in 1888 to $2\frac{3}{4}\%$ and in 1903 to $2\frac{1}{2}\%$. A very large part of the French 3% Rentes are also what is called a perpetual debt, with no obligation on the part of the debtor to repay.

When a Government raises money by borrowing

¹ Chisholm's *Analysis of the Public Accounts*, p. 509.

it thus hires certain of its citizens, or those of any other country who may like to subscribe to the loan, to find money for it, and it does so by promising them a rate of interest, varying according to the state of the money market, its own credit, and the circumstances under which the loan is made. Borrowing thus has this very tempting but always dangerous advantage over taxation, that it enables a Government to get money from the citizens of other countries. Let us leave this consideration on one side for the time and see what are the advantages and disadvantages of borrowing at home over taking money in taxes.

From the point of view of the practical and adroit politician, who wants money for the State and does not want to make himself or his policy unpopular by increasing the burden of taxation, the advantages of borrowing are obvious and overwhelming. To the public the advantages are equally clear and weighty, because the public thinks that by means of the borrowing system it is able to avoid being taxed, and to hand on to posterity the task of finding the money that is required for its present needs.

This view has been dinned into the public ear by economists, financial writers (among whom I must plead guilty to having done my small share), and business men.¹ But it is largely a delusion.

¹ A New York banker's circular, dated April 14th, 1917, says: "Posterity will chiefly benefit from the struggle for freedom and should pay its part."

Let us take the example of the present war. We cannot hand its burden on to posterity. It has to be paid for now by somebody, and all wars have always been paid for during the time in which they were fought and finished up. War cannot be carried on with goods produced or work done either by our ancestors or by our posterity. The goods consumed in war—shot, shells, rifles, food, clothes, horses, motor-lorries, wagons, ships, and everything else—have to be new and up to date, and, apart from the store of them with which the contending nations began, are made and produced as the war goes on. As they clearly have to be in existence before they can be used, it is obvious that they cannot be produced by posterity. Our army cannot eat the bread that is going to be sown in 1930, or wear boots made out of hides whose original owners are yet unborn. Whatever posterity produces will belong to posterity for its own use, and nothing that we do now can deprive posterity of a single ear of wheat that it sows and grows. It is true that when we sell part of our accumulated wealth, in the form of securities, to Americans, in order to pay for goods wanted for the war, or when we borrow in America and contract to pay Americans interest in the meantime and their money back some day, we thereby arrange that a larger share of posterity's wealth will go to America and a lesser share to us; but the sum of posterity's wealth will not thereby be affected, and this only happens when we borrow from, or sell securities to,

other countries, and this side of war finance we are not at present considering. Confining ourselves to that portion—by far the greater—of our war borrowings that are raised at home, we see if we look at the matter steadily that the borrowing policy is only a gilding that makes us swallow a pill and believe that we are eating something good and nourishing. The Government wants money and offers us a beautiful security, with 5% interest, at 95, repayable in thirty years at par, and we calculate that these terms give us a net return of $5\frac{1}{4}\%$ for our money. With the help of a tremendous advertising campaign, and a very real and patriotic effort on the part of a large number of good citizens, the nation hands over 1,000 millions to the Government, and the achievement is very justly hailed as the biggest financial success ever won. It is a perfectly magnificent success. But it does not mean that we have thereby handed to posterity the business of paying for 1,000 million pounds' worth of the war. We have paid now by handing over those 1,000 millions. In return for them we receive from the Government securities, that is, promises to pay interest and repay capital, and the Government can only meet these promises out of our pockets. These securities are assets that we hold, in return for our money, but they are also liabilities that we as taxpayers have to meet; we shall only get interest on our money as the taxpayers pay it, and we shall only get our money back in the same way; and we are taxpayers.

But what of the man who did not subscribe to the loan? He, as far as this loan is concerned, appears to have paid nothing towards the war. If this were really so it would not be a good argument in favour of the borrowing system, for it would make patriotic people pay and leave the others free to spend money on themselves, or invest in other securities at higher rates. But, in fact, those who do not subscribe probably pay more in the long run, because they have henceforward to pay their share of taxation to meet the interest on the loan, and as they do not hold any of it they get no share of interest payment back into their own pockets. The borrowing system gives the citizen the choice of (1) paying up his share of the war cost now by subscribing to a loan, and afterwards being taxed to pay himself interest and to pay himself back, or (2) paying nothing at the time when the loan is issued, and being made to pay regularly hereafter interest and redemption money to those who subscribed. When a Government loan is issued, all the taxpayers on whom the loan charge will fall are, forthwith and at once, jointly poorer by the amount of the loan. Those who have found the money, and paid for the object needed by making a sacrifice now, have an asset to set against the future increase in taxation.

But, it will be objected, a man who has subscribed for £1,000 of the loan will be able to sell it, very likely at a profit, in a few years' time. Then he will have got his money back, and somebody else

will have paid it back to him. Quite true, but the result of his selling will be that he will have got rid of his asset but not of his liability. He will no longer receive interest on the stock that he has sold, but he will still pay interest on the debt, and perhaps money for its redemption, all of which will go into the pockets of the debt-holders, and none into his own. He and his estate after him, in whosoever's hands it be, will have to complete the repayment to somebody else of the money which he thought he had got back again when he sold his stock. By borrowing for war a Government sets up a process by which the war is paid for three times over. First it is paid for as it goes on by the citizens who subscribe to the loans; then it is paid for by the citizens as a whole, who provide the money needed for this purpose, *plus* interest, by taxation; and the Government finally hands the money back (*plus*, perhaps, a premium on redemption) to the original subscribers, or their estates.

The unwieldiness of the whole arrangement is seen best if we imagine a nation composed of citizens all with the same income and taxed to the same extent. Let us suppose that there are ten million heads of families each with an income of £300 a year. The Government offers a 5% loan and they each, being equally patriotic, subscribe £100; this produces 1,000 millions, and each family has £100 less to spend that year, because its £100 has gone into the hands of the Government. They will have

the interest to spend? By no means. In order to pay them their 5% the Government will have to raise 50 millions in taxes (or in another loan), that is, take £5 each out of their pockets and pay it back to them. And as soon as the war is over the Government will set a Sinking Fund to work to pay the loan off. A Sinking Fund is money used for paying off debt, and has to be provided by a balance of revenue over expenditure. If the Government fixes this Sinking Fund at 1%, it will have to take another £1 from the pocket of each citizen, and so they will pay themselves back their capital. If, in the meantime, any one of them sells his £100 stock to a neighbour, he will have got his money back, but he will still as a taxpayer have to pay his £6 a year till the loan is extinguished, so that the effect of getting his money back will be that he will be paying his neighbour interest and capital instead of himself. When we clear the problem by this imaginary example we see at once that the nation paid for the war when it happened, but merely because it preferred to lend instead of being taxed it went through an elaborate process of paying itself all over again, so that it might feel happier about it. It is fairly safe to say that, under such circumstances, an intelligent people would soon awake to the fact that it would save itself and its rulers a good deal of trouble and some book-keeping expense, by submitting to taxation at the time when the war is in progress and writing off the cost of the war at once.

But of course nations do not consist of citizens with equal incomes, equally taxed, and they do not subscribe equal amounts to the loans that are raised by their Governments. This inequality complicates the problem, but does not alter the fact that the war has to be paid for as it goes on, and in so far as it is paid for by raising loans at home, is paid for out of the nation's current income. If we try to pay for it by selling our old investments to one another, those who buy the old investments must have a balance available to pay for them. The generation which lends the money either pays itself back out of subsequent taxation, or is not paid back at all; it cannot be paid back by posterity, because whatever posterity pays it pays to itself. The whole notion that we can leave posterity the task of paying for any part of the war, by borrowing at home, is a delusion. Perhaps it is lucky that we cannot do so, for posterity is likely to have plenty of problems of its own to face. But whatever it produces it consumes. What we can do, and are doing, is to lessen the power of posterity to produce, because we shall hand on to it a less well-equipped industrial and agricultural organization, owing to the fact that during the war we are not saving and putting into capital improvements as much as we did in peace. Before the war we were estimated to be saving and investing at home and abroad some 400 millions a year, so increasing either the power of our own country to make and grow things for us, or the debt of other countries

to us on which they paid us interest in the form of goods and services. During the war nearly all our savings go into furnishing victory for the cause of liberty and progress and protecting our property against external attack. On the other hand, we may fairly hope to hand on to posterity a better organization and a better spirit than we should have bequeathed to it, if we had not learnt many useful lessons from that stern schoolmaster the God of Battles, who has chastened and chastised us for our good.

But as incomes are unequal and taxation likewise, and as people subscribe unequal amounts to loans levied by Governments, let us see what is actually the effect of the borrowing policy. If we compare first the case of two people with the same income lending unequal amounts, we find two people with £1,000 a year, of whom Jones puts £50 into the loan and Smith £500. They will both have their taxes increased to the same extent to pay interest on the loan and provide a Sinking Fund to redeem it ; but one will get £2 10s. a year (less income tax) in interest, and the other £25. If the circumstances of both are the same, this is quite just, because Smith is rewarded after the war for the effort that he made during it by putting half his income at the disposal of the Government when it called on the citizens to subscribe ; probably the interest that he gets will more than offset the higher taxation that the existence of the war debt will necessitate. In the case of Jones, who continued to

spend most of his income on himself, and only put in a small amount to be spent on powder and shot for the army, he will only get a small sum in interest, which will almost certainly be less than the extra taxes that he will pay. So that in cases in which conditions are equal, the interest payment, by rewarding patriotic effort in war time, gives a just and well-earned guerdon to those who saw their country's need and made the right effort to meet it.

But if we find that Jones was educating eight children, whereas Smith was a bachelor, it becomes evident at once that Jones's £50 that he subscribed to the loan was a greater effort—cost him more in health and comfort for himself and his youngsters—than Smith's £500, so that the after-effect of the borrowing system in penalizing Jones and benefiting Smith is highly inequitable. And this is a very serious evil in the aftermath of borrowing by Governments, that by its inability to discriminate between the effort made by the various subscribers it emphasizes the inequities of our system of taxation.

If, then, borrowing has this merely stupid effect that the payment for the object which is secured is carried out thrice, first when the lenders hand their money over to the Government to spend on the desired purpose, and later and more gradually when they hand their money over to the Government to be paid back again to themselves, what are the advantages about it which make it so popular with practical politicians and the public whom they have to keep in a good temper? It

is simply this, that the borrowing system makes us feel happier and keeps us in a good temper because we see the security that we have received and the interest that we get on it, and forget that the interest comes, wholly or partly, out of our pockets and that if the loan is paid back it will be paid in the same way. When we subscribe to the loan we either do so out of money that we borrow—a process that will be considered in the next chapter when we come to deal with the question of inflation—or out of money that we save, or by drawing down our bank balances, in which case, unless we have been stupid enough to keep unnecessarily big ones, we shall save to replenish them. If we save we have so much less to spend on our own comforts and amusements, or so much less to invest in other directions, from which we should have received interest and repayment that would not have come out of our pockets. So by subscribing we hand over our money to be spent on the war and so pay for the war as it goes on. If we do not subscribe but continue to spend as usual, then the taxation involved in order to pay interest and redemption of the loan comes out of our pockets and none of it comes back. So that the borrowing system gives us this choice, of postponing paying our full share of the war's cost during its course, and only meeting it over a period of years by paying taxes needed for the debt charge and getting none of it back in interest or repayment. If we exercise this choice and die immediately

after the loan has been brought out, we apparently escape paying for our share of the war altogether, because we are never taxed to pay interest to anybody. But, in fact, we die so much poorer because the estate that we leave does not contain the amount of war loan to which, if we had done our duty, we should have subscribed, and it does carry with it the liability which will fall on our heirs and assigns to pay their share of the debt charge in taxation. In other words, we have left the job of paying for the war to our heirs, and is not this the same as leaving it to posterity? Yes; but we can only perform this feat if we die at once. If the Government offers a loan for war or any other purpose, all the taxpayers immediately become liable to pay interest on it, and anyone who does not subscribe for such proportion of it as his income and conditions indicate, will consequently be so much the poorer, as long as he is alive, until the loan is redeemed, and will be so much the poorer at his death, because his estate will be encumbered by the debt charge and will hold no asset against it. If he subscribes his fair share he has so much the less to spend when he does so, but afterwards, if taxation is fairly apportioned, has his interest and his share of the loan, as repaid, to set against the extra taxation.

It is commonly said that we are still, as a nation, paying for the cost of the war that our ancestors waged against Napoleon more than a hundred years ago. But this is not so. As taxpayers we

pay interest on the debt then raised. But we pay that interest to those of us who hold the debt by inheritance or otherwise. As a nation we enjoy now all that we produce, and the vagaries of our ancestors only affect the manner in which our production is distributed.

But what happens in the case of loans that are never repaid? Never is a long word, but if we can really conceive that as long as mankind lasts the existing national debts will be outstanding, then the interest charge will continue to be a burden to the citizens as a whole, and an income to the heirs of those who originally subscribed.

Borrowing at home, then, for war purposes or any other, does not, as is usually supposed, shift the burden of payment on to the shoulders of posterity. Whatever it is that the Government is buying, whether it be the services and equipment of an army in the field, or a system of sanitation, or a railway, has to be paid for by somebody at the time when it is provided. By raising the money by a loan instead of by taxation the Government escapes the unpopularity which a great increase in taxation might produce, and hires some of the citizens to pay now, and then taxes them all to pay interest and redeem the debt. Those who have subscribed receive a security which they can sell, and as long as they hold it receive interest which they, in common with the rest of the community, have to find by paying taxes.

The system thus has this advantage in a com-

munity in which wealth is unequally distributed, that it enables those who have a margin of income above the necessities of life to pay for whatever be the object that the Government wants without at the time feeling any poorer, because they get a security that makes them think they are actually richer. If taxation is equitably imposed they will afterwards be taxed to pay themselves interest in proportion to the amount that they ought to have put into the loan when appealed to by the Government. But here comes in a great difficulty, as we shall see when we come to the question of taxation. If those with a margin, who can save without serious discomfort, take up all or the greater part of the loan, and then taxes are imposed on all, whether they have a margin or no, then the system of financing Government spending by loan tends to accumulate more and more wealth in the hands of those who are well off. The subsequent existence of a national debt, held by the citizens, does not affect the wealth of the nation as a whole. The wealth of a nation consists of its material assets in the way of industrial plant, agricultural estates and stock, houses, roads, railways, canals, and so on, and its holding, if any, of foreign investments, and its income consists of the annual produce of these material assets as organized and worked as a going concern by the nation's brains and sinews. These assets and this working power are no less productive because there are some big ledgers at the Bank of England in which are inscribed the

names of certain citizens who have to receive part of the taxes levied on this national produce. But the distribution of the national produce is seriously affected, because it means that the debt-holders, without making any further effort, get for all time, as long as the loan is outstanding, a large slice of the nation's revenue; which has to be found out of its annual produce: and if this debt-charge is heavy and any large part of the nation thinks itself to be overtaxed, there is only too likely to be discontent and resentment on the part of those who pay interest to the holders of war debt and forget that these holders are the people who found the money to pay for the war, or their representatives. If this grievance were acutely felt, it might endanger the stability of property. A system based on property is not, of course, the only conceivable system under which mankind need work for its living. But so far it is the only one that has been found to work, and it would be dangerous to imperil it before we are ready with a substitute. So that, though we cannot by any ingenuity make posterity pay for war or anything else on which we or our Government spend money now, we may by the adoption of the borrowing system leave some very awkward problems to it. Whatever posterity produces it will consume; but the fact that certain members of posterity, descendants of those who paid on our account, will thereby have a prior lien on posterity's produce might have awkward results.

Since, then, the view that borrowing at home puts the burden on to posterity is a delusion, since the goods and services needed for war or for anything else on which a Government is spending have to be found and paid for, by somebody, at the time when the thing is done, and since the system of hiring certain of the citizens to do the paying at that time, and giving them a claim on part of the nation's income in return, may have dangerous consequences when carried far, does it follow that borrowing at home is a policy that is never justified on economic grounds, though it may be necessitated by the exigencies of politics and the need for keeping the public in a good temper at a time of crisis? I think it does, from the purely theoretical point of view, except when the object on which the money is to be spent is an enterprise like a railway, from which a profit may be expected at least sufficient to cover the interest on, and redemption of, the debt put into it. But perhaps a case might be made out for borrowing for purposes, such as education and health, which, if the money is well spent on them, may be expected to improve the country's productive power.

War is certainly the worst purpose for which the borrowing system can be used, because in war-time, especially when war is on a stupendous scale as now, taxation (1) is easily raised, (2) is little if any hindrance to industry, and (3) produces a beneficial effect on the consumption of the community. Moreover war, especially when on a stupendous

scale, is certain to be followed by a period of dislocation and uncertainty in which industry should be as free as possible to contend with the difficulties that face it, and should therefore be as little as possible burdened by taxes that have to be paid to debt-holders. Let us consider these assertions.

(1) Taxation is more easily raised in war than in peace, for the obvious reason that, the nation being patriotically stirred by some cause affecting its honour or its existence, or both, its citizens are readier to hand over their money to Government. In an ideally educated nation with an ideal system of taxation and an ideal Government that could be trusted not to waste its money, this difference would perhaps not appear, because under these circumstances the citizens would always be ready and willing to pay by taxation for objects that the nation had decided to be desirable. But as things are, many people in ordinary times grudge the money that they have to pay in taxes, partly because they have not been taught to see that the common good is their good and that they ought to contribute to it gladly, partly because they often have a suspicion that they are being taxed too much and their neighbours too little, and partly because there is a general suspicion, not to say conviction, that a large part of any money which the Government spends is wasted, owing to the excessive cost of its cumbrous machinery. In war-time these considerations have much less weight, and the citizens, when they pay an extra price for

their tobacco or tea, or draw a bigger cheque for the King's taxes, feel that they are putting something into the Treasury for a great cause, or for the national honour, or to "keep the old flag flying," or to "help the boys at the front" who are fighting for them, or just that "it's war-time," and there's an end of it. At such a time a Government confident in its cause, and in the readiness of the citizens to back it, could, I believe, take a much greater part of the nation's income in taxes than has been attempted yet.

(2) Taxation is less hindrance to industry in time of war, because war in many ways simplifies the task of industry. Industry knows more exactly what it has to produce, and has a better and more certain market. Its difficulty is to get enough men to do the work, and stuff to put into it. At home there is the Government wanting more war material than can be turned out. Abroad there are neutrals full of money that they are making out of selling things to the warring Governments, wanting to buy stuff that they used to get from us and our trade competitors—now busy on war work—and unable to supply their wants. The manufacturer has more certainty that he will be able to sell at a good profit whatever he can turn out, and he is consequently less likely to have his enterprise checked by the existence of high taxation. He is so likely to be able to take most of his taxes out of his customers that, under such conditions, taxation weighs on him much less heavily.

(3) Taxation in war-time is twice blessed. It gives the Government revenue and it checks the consumption of the individual, and this is, at such a time, an equally important economic advantage. Because owing to the enormous demands of the Government on the available supply of goods and services there are not enough to go round, and if the citizens try to enjoy their usual allowance of comforts and amusements—none of which can be provided without using up a certain amount of labour and of stuff, and probably of coal in transport—the result is that the Government and the individual citizens compete against one another in a limited market and force up the price of everything to their mutual disadvantage, and, what is worse, to the great disadvantage of all whose wages or incomes have not risen as fast as the rise in prices has moved. It may be objected that borrowing checks consumption just as efficiently as taxation, since people cannot spend what they lend. This is true if all the money lent is saved, and is not produced by borrowing or inflation, a subject to be dealt with in the next chapter. But even so, when money is taken in taxes and not in loans, people are likely to be thereby stimulated to save something besides. As we have seen, if a man puts £1,000 into a Government loan, he thinks he has got an asset and forgets that it also involves a liability. If £1,000 is taken from him in taxes, he is likely, if at all thriftily inclined, to try to put something away besides.

Further, borrowing in war-time has this great disadvantage, that it penalizes those who go to the front. Doctors who give up fine practices and take a pittance as R.A.M.C. officers, business men, mechanics and miners who forsake big profits and high wages for the pay of officers and privates, come back when the war is over and find that the comrades and competitors whom they left behind have made big investments in war loans, and that they, whose pay has enabled them to do little or nothing in this direction, will be subject to higher taxation to pay them interest. The system thus directly fines those who do the most important war work.

For all these reasons taxation in time of war is greatly preferable to borrowing, and this is still more so when we consider war's aftermath. Every million that we pay in taxes in war-time means that there is a million less of debt to be dealt with when peace comes, and consequently so much more taxation to be taken off, just at the very time when taxation will be the greatest nuisance. Because when peace brings the tremendous problem of putting our industry back on to peace work, with uncertain markets and all kinds of queer problems that are certain to arise, it is above all necessary that our producers and merchants shall feel bold and confident and ready to set the whole machine going in the good hope of bigger production and readier consumption than ever have been seen before in peace time. High taxes, due to a big debt charge

produced by home borrowing, will only go out of one pocket into another, but the taxpayers will not all recognize this, and if they are not also debt-holders it will not console them if they do. So that if taxes have to be kept on at the war level, or even raised, in peace time—as is quite likely if our rulers do not tax vigorously now—the great recovery in trade with which I hope that we may astonish the world even more than by anything that we have done during the war, may be seriously impeded, especially if there is discontent and bad feeling in the country about the manner in which the burden of taxation is imposed. The Germans, who have raised, so far, a quite contemptible part of the war cost by taxation, are likely to find themselves seriously hampered when peace comes by the problem that they are thus creating for themselves.

For these reasons borrowing at home in war-time is not a policy that commends itself on economic grounds. The extent to which it is practised may be taken as a measure of the want of confidence of the Government in itself or in the readiness of the people to make sacrifices for the war, or of its mere thoughtless following of a bad habit handed down by its predecessors.

A well-informed and benevolent despot, with a perfectly docile people, would see that if there is money in the country that he can get by borrowing he can also get it by taxing if he sets about it in the right way, and that by doing so he not only cheapens the war by reducing his subjects' demand for goods

which competes with that of his War Minister, but also makes industrial recovery in peace more rapid and hearty, by the absence of after-war taxation. All the money that he wanted for war he would just take from his people in taxes as the war went on, without going through the cumbrous process of borrowing it from them and afterwards taxing them to pay themselves back. But in order to do so he would have to be able to rely on a truly equitable system of taxation, which would curtail the power even of the richest to waste money on things that are not really needed at a time of national crisis, without taking food out of the mouths and clothes off the backs of those who are hungry and ill-clad.

Borrowing at home in time of peace for some purpose that is, as Adam Smith said, of great national advantage, but not likely to pay, is less objectionable than war borrowing, since the special advantages, set out above, of taxation over borrowing that prevail in war-time are then absent. But it is always dangerous, because it encourages the delusion that a nation can have things now and pay for them some day, whereas whatever it has now it pays for now if it raises the money at home, and the simplest, cleanest, and most honest way of paying for it is by taxation. In the case of revenue-earning enterprises there is very little objection to borrowing for their cost if the revenue is likely to cover the debt charge; but since it is generally admitted that such enterprises are more costly, in most countries, when managed by Government, the

economic argument against their being so managed is strong.

Borrowing abroad, except for reproductive purposes such as railway building, is so evidently "bad business" that it is only done by Governments of economically backward countries, or by Governments which are impelled into this course, against their will, by the force of circumstances, as happened to ours in the present war. The volume of munitions and war goods required for us and for our Allies was so great that we had not the plant ready to provide them fast enough, so we had to buy them from neutrals. As our industry was depleted of its best men and had more work to do than it could manage, it was not possible to pay for these war imports by increasing the volume of goods and services that we exported. So we were obliged to make these payments by drawing on our accumulated capital and by pledging our future production. Some of our accumulated capital was in the form of the bonds and shares of American railroads and of Government and municipal bonds of many neutral countries, which had been acquired by us and by our fathers through the process of investment abroad, that is by providing goods and services in the past and taking securities in exchange for them. These foreign investments stood us in good stead since we were able to ship them back to the country of origin, or to others that would take them, in exchange for war imports. By this means we, as a nation, paid for part of the war's cost out of work done in

former years, by using it to induce foreigners who bought the securities to pay, during the war, other foreigners who were supplying us with goods and services needed for it. By so doing we deprived ourselves for the future of the stream of goods and services that we used to receive from foreign countries to meet the interest on, and redemption of, these securities that we had acquired in former years. This process has very much the same effect as borrowing abroad, which was another means employed by our Government for financing the war. For example, when it raised a loan of 50 millions in America it, in effect, hired certain American investors to pay now for the munitions, etc., that we were importing, promising to pay them in future so much a year in interest. This interest we shall have to provide out of our annual production of goods and services. So that both these processes of financing, by selling securities and by borrowing abroad, mean that we shall have to work harder in future to provide for our own wants, for one reduces the payments that folk abroad have to make to us and the other increases the payments that we have to make to them. But it may be noted that the extent to which we have made use of these methods of paying for war is, so far,¹ roughly balanced by the loans that we have made to our Allies and Dominions.

¹ Written in March 1917.

CHAPTER III

MONEY WATERED BY INFLATION

IN the good old medieval days rulers who wanted more money than they could squeeze out of their subjects by taxing used often to solve the problem by debasing the coinage. This was most easily and effectively done by putting less precious metal and more alloy into coins and then issuing them in payment with all the appearance of having the same value as before. By this process the monarch was able to make a given amount of gold or silver go so much further in turning it into pieces that their unsuspecting subjects would take in exchange for goods, until the fraud was discovered and prices adjusted themselves, more or less.

Nowadays most commercial transactions, except the retail purchases on which we spend our pocket-money, are carried out by means of various forms of paper money, the most important of which, in this country, is the cheque currency with which our banking system provides us. Before the war, we used to carry gold and silver coins for retail purposes, but even then all big payments were made

by cheque. Since the war, gold has practically vanished from circulation, and its place has been taken by Treasury notes, issued under the Currency and Bank Notes Act of 1914, and convertible on demand into gold at the Bank of England. This power, that a modern community has gained, of multiplying its currency by means of the printing press and of banking machinery, makes it easy for Governments when they want money and are shy of taking it directly and openly out of the pockets of the citizens, to debase the currency, not by fraudulently tampering with it in the medieval manner, but by merely multiplying the amount of the paper instruments that will be taken by the public in exchange for goods. The buying power of the public is thus watered down by inflation, if this mixture of metaphors may be permitted. This is a very tempting and attractive method of financing any expensive enterprise, especially a war, because it does not, at first sight, call upon anyone for any such sacrifice as is involved when taxes are raised or when the citizens are called upon to limit their spending, save their money and lend it to the State. By increasing the currency a Government does not take money out of anybody's pocket, but puts new money into the pockets of those to whom it has to make payments. It seems to be a delightfully easy and simple way of paying for things, just to manufacture new money for the purpose, and this device is in fact the basis for all kinds of schemes by which well-meaning currency reformers often believe that

they can make mankind rich, by increasing the volume of the medium by which payments are effected ; whereas the only way by which we can be made really better off is by increasing the supply of things that we need and improving the system by which they are distributed among us. In fact the effect of an increase of currency, unless it is accompanied by an increase in the output of goods, is just the same as that of the medieval debasement. It tends to produce a rise in the prices of all commodities of general use, and so throws the burden of paying for war, or providing whatever be the object that the Government is trying to secure, on the shoulders of the people least able to bear it—namely, ill-paid workers and salary earners and people with small fixed incomes. It is a devious, unscientific, and round-the-corner dodge, and can only be excused on the ground that Governments make use of it without realizing what they are doing, and then continue it because, when once it is started, it is very difficult to stop it, or even to check its growth.

It is simply finance by inflation. The subject is difficult and technical, and to enter into all its intricacies would involve us all in much confusion and weariness of mind, and would also fill out a portly volume. But if we keep to the broad outlines of the matter, it seems to me that the case against it is plain to the understanding and convincing to common sense. Professor Foxwell, in the course of a lecture on Inflation, lately gave an excellent

illustration of the effect of the quantity of currency on prices from a remark of Dr. Johnson's. When told that in Skye twenty eggs might be bought for a penny, Johnson observed : " Sir, I do not gather from this that eggs are plenty in your miserable island, but that pence are few." There it is in a nutshell. If currency is scarce, prices are low. If it is plentiful, prices are high. By inflation I mean an increase in the currency more rapid than in the volume of commodities and services that the community is producing. When this takes place, if at the same time what is called the velocity of the circulation—that is, the pace at which money is turned over—remains the same, it is impossible to avoid the conclusion that a rise in prices must happen. Let us see the process at work in an imaginary example.

If we all woke up one morning to find that some well-meaning fairy had doubled the amount of money in our pockets and in our banking accounts, and if at the same time no more stuff and services were being produced, we should all, probably, feel nice and rich until we found out that everybody else's money had also been doubled ; then if at the same time there were no increase in the things that money is used to buy, the stress of competition would make the price of everything shoot up like a rocket. If the price of everything, including labour, services and capital, were exactly doubled, then we should all be exactly as we had been before, with regard to our power to buy ; but in fact there would be a

painful process of adjustment in which those who were strongest in bargaining power would do best out of the scramble and the weakest would fare worst. Moreover, those who had made investments in house property, mortgages or securities, entitling them to so many pounds a year for a term of years or for all time, would find that the buying power of their so many pounds had been greatly lessened, but that they had no right to make their tenants or their debtors pay them more than was stipulated in the original contract. The result, then, of such an increase in the currency as we have imagined would be a great upsetting of the community's economic relations, with a rise in prices followed by a rise in wages for those who were strong enough to secure it, probably much friction and many strikes before this adjustment was secured, a good deal of injustice to unorganized workers and people like clerks and typists who are too respectable to strike, and a very unfair advantage to debtors, who would be able to pay interest and repay capital to creditors in currency that had been debased to the extent of about half its value.

If inflation took place on this wholesale scale, we should all see at once what was happening, but of course it does not. It is usually done, even in times of acute crisis, so gradually that its effect is not observed until it is too late to remedy the evil by drastic measures, without raising a fresh crop of awkward problems. In normal times inflation is, as a rule, only practised on a very modest scale,

though it is said that there have been examples of economically backward States that worked the printing press so hard that at last their paper became so worthless that it did not even pay to print it. If inflation really has the excuse, like the unauthorized baby, of being "only a very little one," its effect is hardly noticeable, and it appears to work a very comfortable miracle. There is the famous example, referred to in Jevons's book on *Money*, Chapter XVI, of the Guernsey market, which was "built without apparent cost." The Governor of the island wanted to build a market, and, not having the wherewithal, "issued under the seal of the island four thousand market notes for one pound each, with which he paid the artificers. When the market was finished and the rents came in, the notes were thereby cancelled." The whole transaction was completed, and the market had seemingly been built out of nothing. In fact it had been built by means of temporary inflation, the effect of which would tend to raise the prices of all the goods that the community was consuming. Jevons indeed considers that the infusion of those notes into the currency drove out so much gold. If that really happened, then there would be no inflation, because paper would have taken the place of gold in circulation and there would have been no increase in the total currency in the hands of the Guernsey folk. But Jevons does not state that gold was, in fact, actually driven out; and with all deference to his authority, the explanation

of the miracle given above seems to me more probable.

In order to avoid misunderstanding, I think it is better to make it clear that by inflation I mean any increase in any form of currency, whether metallic, legal tender, or other—coins, bank notes, postal orders, or cheques—that is accepted in payment by the community. It is quite possible to have inflation by too great an inrush of gold, as several neutral countries have found in the course of the present war. But when it is a matter of too much gold, then equilibrium can be restored in ordinary times by the export of the gold, because it will be taken in payment elsewhere; but a country's paper money is not available as an article of export.

In normal times, such inflation as we are liable to is usually corrected by gold exports and the operation of other economic processes. If a country's currency system is sound, the inflation process should thus carry its own remedy with it. In our case, if we get in too much gold, or our banks create too much cheque currency, the consequent rise in prices tends to check our exports and increase our imports of goods. Thereby in the first place the volume of goods offered in our home markets increases and so the relation between goods and currency is helped to return to the former level, and in the second, as we are importing more goods and exporting less, there is a tendency for gold to be shipped to pay for some of the extra imports. So

that if we are suffering from too much gold, the cure begins to work; or if it is a case of too much banking credit, the export of gold calls attention to the diminished basis of this credit and so helps to cure it.

In war-time, if the war is big and obtrusive enough, these nice and pretty checks and balances do not work to keep inflation down. Shipping gold is made expensive by high rates of freight and insurance; and the people who usually handle the business of shipping gold, and do so, in peace time, whenever they can see a profit in it and sometimes merely to get the advertisement that gold shipments usually bring with them, are checked by patriotic motives and the desire to avoid exporting a financial weapon which has to be kept for special uses. And so inflation can proceed merrily without setting to work the automatic mechanism that usually produces the antidote for the disease.

How merrily inflation can work, when it is thus given its head, the experience of the present war has well shown. All the warring countries have been calling in gold from circulation and replacing it with a much larger quantity of paper. Much of the gold that they have called in they have shipped to neutral countries to pay for goods, and so all over the world there is this common experience of an increase in currency over and above the supply of goods, and a more or less universal rise in prices. The thing has gone to such a pitch that the Scandi-

navian countries have in effect closed their ports against the entry of gold, and in America the danger of the inflation produced by the great mass of gold imported has long been a commonplace among economic writers.

The method of inflation differs in each country according to the arrangements of its currency system. During the present war we in England are doing it in three or perhaps four ways. The Government has done it by printing paper currency, much greater in extent than the gold which it has replaced in circulation, and by minting a great quantity of silver. The Bank of England has done it by lending money to the Government, to Allies, to Colonial Governments, and to private individuals; and the other banks have done it by increasing their investments in Government securities and by making advances to customers in order to enable them to take up Government securities. In other words, most of the inflation has been due chiefly to the action of the Government in either directly increasing the currency itself by printing or coining it, or in borrowing money from the Bank of England and the other banks instead of getting it out of the pockets of the public by taxing it or borrowing its savings. It is entirely natural that the Government should have done this, because in peace time it does so habitually and as part of its regular scheme of finance. It borrows from the Bank of England on Deficiency or Ways and Means advances to tide it over a time when taxes are coming in sluggishly,

and on the other hand big payments have to be made, and for like reasons it sells Treasury bills, or temporary promises to pay, to the Bank of England or to other banks. These devices are, usually, on so small a scale, as compared with the vast sum of our monetary turnover, that the consequent addition to our currency has no noticeable effect. But the huge scale on which they have been used in this war has had bad results for all parties.

As many people may be puzzled by the assertion that the Government increases the currency by borrowing from banks, it is better to explain the process briefly here, though in another book I have already shown how loans made by banks produce manufactured money by adding to the banks' deposits, which embody the right of their customers to draw the cheques which are the chief form of currency that we now use.¹

When the Bank of England makes a loan to the Government or subscribes to any issue of Government security, it increases its holding of Government securities as shown in its weekly return. When it makes advances to any less august borrower, it increases its holding of what it calls Other Securities. In either case it increases, on the other side of its return, the amount of its deposits, which, as the appended specimen shows, are divided into Public and Other, the former being the balances of the various departments of the British Government,

¹ *Meaning of Money*, pp. 64 et seq.

and the latter those of all other depositors, including the other banks :

BANK OF ENGLAND

BANKING DEPARTMENT

July 1st, 1914

	Million £		Million £
Capital . . .	14½	Government Securities .	11
Rest . . .	3½	Other Securities . . .	49½
Public Deposits . .	17	Reserve . . .	28½
Other „ . .	54½		
	<u>89½</u>		<u>89½</u>

Anyone to whom the Bank of England makes an advance thereby gets a credit in its books, and so the amount of the deposits at the Bank is increased by the amount of the advance. If the Government is the borrower, the advance is added both to the Government Securities among the assets and to the Public Deposits among the liabilities; but as the Government does not borrow money in order to have the pleasure of contemplating a large balance at its banker's, it sooner or later makes payments, out of this deposit, to contractors or other folk to whom it owes money, by means of cheques on the Bank of England; the contractors pay these cheques into their own banking accounts, and so the money originally lent by the Bank of England to the Government is transferred from the Public to the Other Deposits, to the credit of the other banks to whom it has been distributed, and henceforward it figures as cash at the Bank of England in their

balance sheets. If the Bank of England makes an advance to any other borrower, he is credited with a corresponding deposit. He draws on it and transfers it to anyone to whom he has to make payments, but the deposit remains to the credit of someone as long as the advance is outstanding. How far this process has been carried we see from the figures of the Bank of England's return published at the end of last year, comparing with those at the end of June 1914 ¹ given on a previous page:

BANKING DEPARTMENT

December 27th, 1916

	Million £		Million £
Capital . . .	14½	Government Securities .	57
Rest . . .	3½	Other Securities . . .	106½
Public Deposits . . .	52	Reserve . . .	33
Other „ . . .	126½		
	<u>196½</u>		<u>196½</u>

Here we see an addition of more than 100 millions to both sides of the balance sheet, by increases in the securities on one hand and in the deposits on the other. These deposits are potential currency and more, for being "cash at the Bank of England," in the hands of the other banks they are regarded as just as good a reserve for them as gold or legal tender. Let us see the effect on the other banks of this increase in the currency which may be called, in a sense, part of the basis of their credit operations. I append an aggregate balance sheet

¹ These dates are chosen to fit those of the balance sheets of the other banks, which are only published half-yearly.

of nineteen of the biggest English banks, showing their position first on June 30th, 1914, the last date on which they were published before the war, and then on December 31st, 1916 :

AGGREGATE BALANCE SHEET OF NINETEEN PRINCIPAL
ENGLISH BANKS

June 30th, 1914

	£		£
Capital and Re-		Cash in hand and	
serves . . .	69,864,000	at bank . .	115,242,000
Acceptances and		Investments . .	114,583,000
Endorsements	37,646,000	Discounts and Ad-	
Deposits (includ-		vances (includ-	
ing undivided		ing money at	
profits, etc.) .	747,243,000	call, etc.) . .	571,451,000
		Cover for Accept-	
		ances, Pre-	
		mises, and Sun-	
		dries	53,477,000
	<u>£854,753,000</u>		<u>£854,753,000</u>

December 31st, 1916

	£		£
Capital and Re-		Cash in hand and	
serves . . .	72,497,000	at bank . .	251,875,000
Acceptances		Investments . .	303,461,000
and Endorse-		Discounts and Ad-	
ments . . .	57,498,000	vances (includ-	
Deposits (includ-		ing money at	
ing undivided		call, etc.) . .	592,056,000
profits, etc.) .	1,095,574,000	Cover for Accept-	
		ances, Pre-	
		mises, and Sun-	
		dries	78,177,000
	<u>£1,225,569,000</u>		<u>£1,225,569,000</u>

The most notable features in this very instructive comparison are the increases in the deposits on the liabilities side and in the cash and investments among the assets, that has taken place during the period. It will be observed that the deposits, which are potential currency in the hands of the public, since they give the banks' customers the power to draw cheques against them, have risen by 348 millions, while the cash held by the banks has risen by 136 millions, their investments by 189 millions, and their loans and discounts by 21 millions. How much of the addition to the cash is due to the Bank of England's lending activities, as described above, how much to the issue of Treasury notes, of which 150 millions were outstanding on December 31st last, and how much to gold paid in by customers, it is impossible to guess, but it is safe to assume that these three processes between them have done most of it. But a still larger movement is the increase in investments, the whole of which, it is safe to guess, has been due to the big subscriptions made by the banks to the two first War Loans, and to Exchequer bonds and Treasury bills, by means of which they increase on the one hand their investments and, on the other, the deposits of their customers,—by this process. When they subscribe to War Loans or buy Treasury bills from the Government, the banks pay for the securities so taken by a draft on their balance at the Bank of England, and so, for the time being, hold so much less cash at the Bank of England

and so much more investments ; but as the Government uses its increased balances to pay debts, by drawing cheques on them, and the contractors who get the cheques pay them into their banks, the banks get back their balances at the Bank of England and also have their deposits increased, by the cheques on the Bank of England, which their customers pay in ; and so when the transaction is all complete the banks find themselves with their deposits increased by the amount that they have subscribed to the new loan, or whatever the security may be. In other words, they and the Government between them, by this credit operation, have increased the amount of currency in the hands of the public, and if at the same time there has been no corresponding increase in the volume of goods, inflation is thereby produced. The figures given above are complicated by the addition, during the period, of two small banks by amalgamation ; but if banking figures of the whole of the United Kingdom could be compared, the total increase in deposits, that is in potential currency, would be over 400 millions.

A similar process is set to work when a bank makes an advance to a customer to enable him to take up War Loan, or any other security, or for any other purpose. As I have shown elsewhere,¹ as long as the loan is outstanding there is almost certain to be a deposit in some bank or other against it. The banks had not, up to the date of

¹ *Meaning of Money, loc. cit.*

the balance sheet shown above, done much of this business since the war. In fact, owing to the extent to which industry is now on a cash basis and owing to the decrease in Stock Exchange speculation, the increase in loans and discounts of the banks was quite small. But during the first quarter of this year they must have made very large advances to customers, since everyone was urged to anticipate future savings, borrow from his bank and subscribe to War Loan, and we know that the public responded very practically to this appeal. This was quite as it should be, since it was only by anticipating savings that the huge amount required could be got ; but, as was pointed out at the time by Professor Pigou, in a letter to the *Times* of January 19th, 1917, unless the money so subscribed was saved and paid back to the banks, so cancelling the increased credits, as fast as it was spent by the Government, this system of subscribing out of bank advances could only lead to inflation.

The banks are, among other things, manufacturers of currency, and as long as their manufacture does not outstrip the pace at which goods are being produced, the general level of prices will remain fairly level. Or if new currency that they create is used by producers to set to work and make more goods, then by creating it they are helping the production of goods and so maintaining the equilibrium between goods and currency. It is when they manufacture currency that is handed straight over to a great consumer like a Government in war-time, that

inflation can almost be seen getting to work. A new buyer comes into the markets, with a great mass of currency to draw on, competing with all other buyers and probably, from what we know of Government departments, with itself,¹ and up go prices. It is a subtle, insidious, but very effective way of getting money out of us, not by taking it from us, but by watering down the value of all the money that we possess. As the prices of goods rise our buying power over them declines, and so we have to put up with less of them. This is right and reasonable if they are wanted for the nation's needs, but the inflation process does the job in the worst possible way by throwing the burden of going without on those who are least able to bear it.

Inflation, however, does not only hit the poorest members of the community. It is bad finance for the Government that indulges in it to any extent that suffices to cause any serious rise in prices and depreciation in the currency. In the first place, the Government drives prices up against itself and so makes the war, or whatever else be the object of its spending, more costly. In the second, the Government, being not only an inflater but a borrower, since it is by the borrowing process that much of the inflation is done, borrows at a time when the currency is depreciated by its own action and engages to pay interest and pay the debt back in

¹ A report of the Committee of Public Accounts quoted in the *Economist* of August 26th, 1916, p. 357, shows that the Admiralty and the War Office were buying against one another.

years hereafter, when we may fairly hope that prices will have gone back from their present level. Consequently it borrows millions of depreciated pounds with a fair prospect of having to pay back its debtors later on with pounds that will be much more valuable. Unlike the quality of mercy which blesseth him that gives and him that takes, the system of financing by inflation curses both the inflater and the inflatee.

"But," it is argued, "you cannot possibly get away from inflation in time of war. It is inevitable. The rise in prices makes a larger amount of currency necessary." But could there be a general rise in prices without an increase in the volume of currency? There could, of course, if there had been a decrease in the production of goods. But if the production of goods had remained fairly constant, as it probably did if we include war material as goods, and if there had been no increase in the volume of currency, then, I think, though certain prices must have risen, others must have fallen.

The price of carriage by sea could not help rising, owing to the demands on the merchant fleets of the world by the warring Governments, the shutting up of Germany's ships in neutral harbours, and the destruction of Allied and neutral tonnage by German submarines. This would have meant that everything that came by sea would be dearer, so that food prices must have risen. At the same time, the more generous diet required by the fighter and the war worker would have had a like effect,

War materials would also have inevitably been dearer. But if there had been no increase in the currency, the greater volume of it required for purchases of food and war material would surely have lessened the amount available for buying other things and their prices would have fallen, and the decreased demand for them might have set free labour employed in producing them and so helped to increase the production of food and war material and checked the rise in their prices. Without inflation private extravagance would have been much less general. If, for example, the higher prices paid by the Government for the petrol which it was using in such huge amounts had diminished, by their full extent, the supply of money that other people could pay for it and for other things, we might have heard less about race meetings thronged with private cars in the third year of the war. But as long as the Government and the banks kept ladling out fresh supplies of currency, competition between the State and the citizen for the goods and services available became ever keener, to the detriment of both parties. As more money went into buying potatoes, owing to the rise in their price, less, if it had not been for inflation, might have gone into buying flowers, and so ground and labour used for growing flowers, would much more rapidly have been used for growing potatoes, and the rise in the price of potatoes would have been checked. As more money was needed for ocean-carried food, less would have been in buyers' pockets,

if there had been no inflation, for ocean-carried furs and feathers and wine and silk dresses, and so more ship space would have been set free for food, and the rise in its price would have been checked. In other words, if all the money required by the Government for the war had been taken out of the pockets of the public in taxes and loans paid for out of savings, instead of much of it being manufactured by the Government and the banks between them, then the public's buying power would have been reduced by the full amount spent on the war ; and the reduction of consumption, by which alone war's needs can be met, would have been brought about with much less friction and economic disturbance.

For, as has been said over and over again in the course of the War Savings campaign, the Government makes war with goods and services. Those that it needs for war can only be handed over to it if somebody goes without. It cannot by any possibility, or by any financial sleight of hand, get more than the country can produce, either by its own labour and energy or by selling goods abroad in exchange for war goods made abroad, *plus* the amount that it can get abroad by borrowing and selling securities. As a warring country's power to borrow and sell securities abroad is obviously limited, it is clear that after a certain point the war demand for goods and services can only be met by the reduction, enforced or voluntary, of the buying power of the civilian population. Inflation helps to effect this in an insidious, roundabout, and

inequitable manner, laying much of the war burden on the wrong shoulders. It is not the sole cause of all the rise in prices, but by encouraging extravagance it helps to raise the prices of goods that need not necessarily rise at all, and it increases the rise in prices in which a rise is inevitable.

As has been said, inflation does not "cut much ice" in normal times. But it is like one of those diseases that demoralize the patient into enjoying them, and war's experience shows us that we shall have to be careful to get cured of it as quickly as we can without starting some other ailment, and then keep it out of our system.

CHAPTER IV

MONEY TAKEN BY TAXES

GIVEN a free people with real control over the conduct of its affairs, a genuine confidence in the justice of the system by which money is taken from it and in the wisdom and care with which the money is spent, and the citizen would no more object to paying taxes than he objects to paying a bill for a book, or a suit of clothes, or a set of golf clubs that he has ordered for himself. The prevalent spirit on the subject shows how very far we are from having attained these ideals.

"All taxes are confiscation," said Mr. Joseph Hume as already quoted, so expressing the common view that the State takes our money in an arbitrary and unjust manner and spends it on purposes which may be necessary but are only submitted to reluctantly on that ground, the said expenditure being necessarily and inevitably a cause of the impoverishment of the people. In the last century, in the heyday of the simple and satisfactory theory that every man knew his own interest best and could be trusted to secure it if left alone, and that by this pleasant process the interest of the whole com-

munity would certainly be attained, it was a favourite phrase with politicians and political writers that such money as was saved from taxation would "fructify in the pockets of the people."

How much truth is there in this view? It is surely a very large assumption to suppose that all the money which Government takes would, if left in our pockets, have been spent on some good and useful purpose and have increased the productive power of the community. This theory takes it for granted that the Government's revenue is derived entirely from money which would otherwise have been saved and well invested in reproductive enterprise. Whereas we know that, owing to defects in the machinery of our joint stock system and the ingrained craving in the hearts of most of us for short cuts to fortune, a good deal of the money that is invested gets into the pockets of unsavoury company promoters and the evil brood employed by them, or is sunk in enterprises that never had a chance of yielding a profit to their shareholders; and further, it by no means follows that what the Government takes comes out of what the citizens would have saved. Very probably it comes out of what they would have spent on themselves; and only the most incorrigible optimist, or the most ignorant theorist, could maintain that whatever people spend on themselves is spent well. The vulgarity and absurdity and ugliness of many of the objects on which the rich and middle classes spend their money

are apparent to all : lavish entertainments at which most people are bored, theatrical shows which are a scarifying criticism of the intelligence of those who pay money to be amused by them, clothes and gewgaws in which no really civilized people would consent to be found dead,—these are a few of the more innocent examples of the manner in which hundreds of millions of money that the State does not take, “ fructifies ” in the pockets of its more fortunate citizens. Bad spending among the poor is perhaps even commoner, owing to their ignorance of the uses of money, and is much more tragical in its effects owing to the fact that, even if they spent well, they would seldom have enough to give them a reasonable chance of full development of their faculties and capacities.

Since, then, there is much bad spending in all classes, we have no right to assume, as is often done, that all the money taken by the State and spent, well or ill, by it, would have been well spent if left to “ fructify in the pockets of the people.” It might have gone in race meetings, Tango teas, picture palaces, fashionable fripperies, strong drink, or trashy “ literature,” all of which things have their uses in amusing people who do not know how to amuse themselves better, but do not lead to much “ fructification.”

It may also be mentioned here that money taken by Government does not vanish. It is spent by the Government on something, and thereby provides a large number of people with a living. When it is

spent on the debt-charge, it is handed straight over to the debt-holders, in interest or redemption of debt. Spent on education, it pays those who build schools and on the army of patient workers who teach the rising generation—if spent well, no money could be better invested, or fructify more fruitfully. Even when spent on public defence it provides wages for those who build our navy and make our guns, and feeds and clothes those who fight for us. It is true that if we had universal peace all those good workers might be building merchant ships instead of battleships, or making and growing useful things instead of learning and practising the art of destruction. But as things are at present, national security is a thing that most of us are very willing to pay for, and with private spending what it is, we cannot be sure that by any means all the work of these workers, if set free from military and naval objects, would be put to good and fruitful use. It is of course absurd to go to the other extreme and contend that taxation creates employment. It only transfers the power of giving employment from individuals, who might or might not have used it well, to the State, which may or may not use it well.

No chapter on taxation can be complete that does not quote Adam Smith's famous four maxims on the subject :

“(1) The subjects of every State ought to contribute towards the support of the Government, as

nearly as possible, in proportion to their respective abilities ; that is, in proportion to the revenue which they respectively enjoy under the protection of the State.

“(2) The tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor and to every other person.

“(3) Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it. . . . Taxes upon such consumable goods as are articles of luxury are all finally paid by the consumer, and generally in a manner that is very convenient for him. He pays them little by little, as he has occasion to buy the goods. As he is at liberty, too, either to buy or not to buy as he pleases, it must be his own fault if he every suffers any considerable inconveniency from such taxes.

“(4) Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the State.”¹

These maxims have been generally accepted by later economists as a summary of the principles on which taxation should be based, except the very lucid and sensible American writer General F. A. Walker, who decided that “the first and most famous of them cannot be subjected to the slightest test without going all to pieces.” As to the other three, their equity and sound sense can hardly be

¹ *Wealth of Nations*, Book V, Chap. II, Part 2.

disputed (though Walker thought them "at the best, trivial"), and it is also pleasant to observe that our system of taxation is not far from securing them. If we fail in the matter of No. 2, it is our fault rather than the State's; if we chose we could all know how much we are paying for government when we buy a glass of beer or a pound of tea or a packet of cigarettes, and if many of us buy these things every day without even knowing that we are paying taxes, that is only because we have not troubled to think about it. As to No. 3, the convenience of the contributor might be still further consulted if income tax could be paid by instalments, instead of in one lump as it was before the war, or in two as now arranged. A system of monthly instalments would be much more convenient to a large number of taxpayers, and, though it might involve a good deal of book-keeping, it would, on the other hand, help to keep the State's income even, whereas the present system leaves long periods during which it has to borrow in anticipation of taxes to be received later.

But it is in Maxim No. 1 that the whole question of the equitable apportionment of taxation is really locked up; and, if we examine the great American economist's severe criticism of his great Scottish predecessor, it will help to a clearer understanding of the whole matter.

"This maxim [says Walker], though it sounds fairly, will not bear examination. What mean

those last words 'under the protection of the State'? They are either irrelevant, or else they mean that the protection enjoyed affords the measure of the duty to contribute. But the doctrine that the members of the community ought to contribute in proportion to the benefits that they derive from the protection of the State, or according as the services performed in their behalf cost more to the State, involves the grossest practical absurdities. Those who derive the greatest benefit from the protection of the State are the poor and weak—women and children and the aged; the infirm, the ignorant, the indigent. Even as among the well-to-do and wealthy classes of the community, does the protection enjoyed furnish a measure of the duty to contribute? If so, the richer the subject or citizen is, the less, proportionately, should he pay. A man who buys protection in large quantities should get it at wholesale prices, like the man who buys flour and meat by the car-load. Moreover, it costs the State less to collect a given amount from one taxpayer than from many."¹

Walker's admirable lucidity endears him to economic students, so often baffled by the obscurity in which the masters of the science enfold their utterances, but, I think, these criticisms of Adam Smith only serve to bring out the truth of the principles that lay behind his famous first maxim. For Walker implies that the poor and weak, women and children and the aged, enjoy most revenue under the protection of the State, which they obvi-

¹ *Political Economy*, Part VI, §§ 588 *et seq.*

ously do not. It is very true that the poor need protection, but they do not need it in respect of any property that they own or of revenue that they enjoy. The protection of property, which, as we saw in Chapter I, is the original and still a most important function of the State, has to be given in increasing measure as the extent of the property owned, and the revenue derived from it, increases. A small clerk whose property consists of the balance in his pocket of his last month's wages needs little protection from the State or anybody else. "*Can-tabit vacuus coram latrone viator.*" His employer, with some furniture in a rented suburban house, a few hundreds invested, and a policy on his life, has little that a burglar could get at, though his investments and his business make his revenue depend on the general stability of society, such as is provided by Government. A great landed proprietor with an agricultural rent-roll and a square mile or two of house property in cities enjoys his revenues only because the State is there to protect his property and enable him to enjoy it in peace and safety. As Adam Smith says in another passage:

"It is only under the shelter of the civil magistrate that the owner of that valuable property which is acquired by the labour of many years, or perhaps of many successive generations, can sleep a single night in security."¹

¹ Book V, Chap. I, Part II, "Of the Expense of Justice."

Walker's contention that those with least property require most protection for it almost looks as if it had been dictated by a desire to pick holes in his illustrious predecessor. And his argument that the physically weak, women and children and the aged, need more protection for their property is very little sounder. For if we went back to a state of anarchy and everybody took what he could get, the strong man would certainly have an advantage, but he would not long enjoy much revenue under such conditions, because production would promptly be brought to a standstill. As to the "reduction on taking a quantity" argument—the view that the rich should buy protection more cheaply because they need more of it, on the same principle that enables a man to buy bread and meat more cheaply by the car-load—here Walker is surely quoting the principles of the market-place in a sphere to which they cannot be applied. The merchant with a big stock of an article, which he may or may not be able to sell, is naturally willing to make a concession in price to a buyer who will take a line off his hands, though even in the market-place this principle, or rule of thumb, does not work always, or beyond a certain point. But a Government providing its people with protection for their property works under quite other conditions. It knows exactly how much it means to provide, and it ought to be able to find out which of its citizens will be most benefited by this protection and apportion the cost upon them accordingly by taxation.

So when Walker goes on :

“ Returning to the maxim of Dr. Smith, I ask, does it put forward ability to contribute, or protection enjoyed, as affording the true basis of taxation ? Which ? If both, on what principles and by what means are the two to be combined in practice ? ”—

when he puts these posers we have an easy answer. Ability to contribute, since it depends on revenue enjoyed (when we have got at the right meaning of that ambiguous phrase), involves also protection enjoyed, so that both principles lead us to the same end. And the two can be combined in practice and are, in a halting manner that needs improvement and expansion, in the system of taxation that has been painfully evolved in this country. Logically applied, Adam Smith's first maxim would confine taxation to direct taxation, that is taxation paid directly by the taxpayer to the State, assessed on a graduated scale according to the taxpayer's net income and differentiated according to the source from which it is derived. In other words, by laying down this maxim he anticipated the beauties of the income tax and death duties, and of the principles of graduation and differentiation that have been so slowly and tentatively introduced into our fiscal system. All these things are implied in the prophetic musings of the great Scottish thinker.

Graduation is clearly implied, as was shown by Walker's criticizing Adam Smith for having apparently forgotten it, because he did not actually

mention it. We cannot put the proof better than in Walker's words :

“ Is the ability [he asks] of two persons to contribute necessarily in proportion to their respective revenues ? Take the case of the head of a family having an income of \$500 (£100) a year, of which \$400 (£80) is absolutely essential to the maintenance of himself and wife and children in health and strength to labour. Is the ability of such a person who has only \$100 (£20) which could possibly be taken for public uses, one-half as great as that of another head of a family similarly situated in all respects except that his income amounts to \$1,000 (£200), and who has therefore \$600 (£120) which could conceivably be brought under contribution ? Manifestly not.”

Most true, but there is nothing to show that Adam Smith thought that it was. Anyone who has only £100 a year, of which £80 is needed for the bare necessities of “ health and strength to labour,” can hardly be said to enjoy a revenue at all, for the whole of his margin is needed for the decencies and comforts that must be had before he and his children can be provided for in such a manner as is necessary to make them efficient citizens of a civilized state, with their intelligence cultivated to a point that will enable them to exercise judgment concerning public questions. Those only can be said to enjoy a revenue who have a margin over what is needed to maintain them and their dependents in health and efficiency. To tax anybody

below that line is bad business from the State's point of view, because by injuring their health and efficiency the State promotes the growth of a class that is compelled to live, more or less, either on private charity or public support, and by its lack of efficiency impairs that of the nation at a time of crisis.

This principle is recognised by the terms on which our income tax is assessed. It would not be imposed on a man with £80 a year at all. Graduation, the system by which no income tax is imposed below a certain limit, and varies afterwards according to the size of the income, is the great advantage that income tax carries with it. The release of small incomes has always, necessarily, been part of it. When it was first introduced in 1798 it was only imposed on incomes of £60 and upwards, was graduated between £60 and £200 and was 10% above that line¹; in 1806 the limit of exemption was reduced to £50. Its medieval predecessor, the poll tax, was first raised in 1377, and was graduated. Beggars paid nothing, ordinary folks 4*d.* a head, and the rate varied from this level up to 10 marks (£6 13*s.* 4*d.*) on dukes.² The income tax was, most unwisely, taken off after the Napoleonic wars, and when it was reintroduced in 1842 by Peel, it was imposed on incomes of £150 and upwards.³ This level was later raised to £160, and was reduced in

¹ Chisholm's *Analysis*, p. 424.

² *Ibid.* p. 416.

³ Seligman, *The Income Tax*, p. 132.

Mr. McKenna's first War Budget in 1915 and brought down to £130, which seems to be low enough as it is at present assessed, but by no means as low as it should go if and when the tax is rid of a great anomaly that at present mars it, namely, its great unfairness to those who have families to educate. But before we look further into this and other drawbacks that at present clog an otherwise excellent tax, let us consider its other beauty, that of being differentiated according to the source of income, whether "earned or unearned."

This, again, is a principle that has only fought its way with the utmost difficulty into our system of taxation, though the logical soundness of it is obvious. It is clear that two men, each with £1,000 a year, do not "enjoy" a revenue of this amount in the same sense, if one of them earns it as a salary by hard work, which will cease at any time if, owing to bad health or advancing years, he has to give his work up, while the other receives it in dividends on well-chosen securities which he has inherited or bought out of his own savings, and is therefore certain of enjoying it as long as he lives and of being able to hand it on when he dies to his children or anyone else whom he may choose. It has not yet been possible to differentiate still further and impose a different rate of tax on the income that a man receives from investments which he has saved himself from that which is paid on an inherited income. When a taxpayer has created, by saving, his own "unearned" income, it is at first sight

unfair that it should be so called and so taxed. But, even so, his enjoyment of it is clearly so much the more secure, and moreover the principle of differentiation is also at work through the death duties, which take a large and well-graduated slice out of estates when the demise of their owner gives the State its periodical opportunity. So that the incomes of those who live on inherited wealth, besides paying income tax, is either diminished every time an owner of it dies and the State takes toll of the capital, or is lessened each year by the provision that the owner makes, through insurance or otherwise, in order to provide against the death duties, and maintain the capital of the estate intact.

It is commonly objected to the death duties that they are a tax on accumulated capital and that, as the State uses their proceeds for purposes of ordinary expenditure, it is paying for current needs out of capital and so doing a thing that is vicious in the case of an individual or company. But is this necessarily true? The tax, it is true, is assessed on capital, but I think it is paid, and that all taxes have to be paid, out of current income, either of the previous owner of the estate, if he insured in order to provide for it, or of its inheritors, if they do not realize any portion of the estate to meet it, or of those who buy, with saved money, any part of the estate that is sold to meet the tax. In the last-mentioned case, the saved money that is handed over to Government to spend would otherwise have gone into some other investment which would

perhaps have increased the community's productive power, but this possibility is attached to all money that the Government takes out of our pockets and is one of the reasons why we have to be careful to see that the Government spends it well. A graver objection to the death duties is that they may tend to check the incentive to accumulation by the individual, a point that will be dealt with later.

All taxation comes out of somebody's income. If we try to tax capital, we can only do so if the owner can pay the tax out of income or can sell a bit of his capital to someone else who pays for it out of his income. A tax on capital is thus only a way of assessing income tax according to the amount of capital possessed, and is a questionable way of doing so because of the difficulty of knowing what anybody's possessions are really worth until they are offered for sale in a free market, and also because of the great expense and delay involved by making any such valuation. Moreover, the mistakes made by Government valuers, when estates have to be valued for purposes of taxation, are astonishing. In a certain colony a man once died who had picked up, in the course of several visits to England, a collection of beautiful and very valuable Turners and other water-colours. The local official valuer remarked to his heir, "I see from the dates on these pictures that they're all second-hand, so I've put them in at half a crown each."

But since all taxation falls on income, and since the amount of the income, with due regard to its

source, is the obvious test of ability to pay, and since this ability clearly grows with each increase in the income above the sum required for the bare necessities of life, it is evident that the income tax, if we could get it into an ideal shape, is the most equitable form in which taxation can be imposed. Regard to the amount of the income involves graduation, and regard to the source of the income involves differentiation, because it is easier to pay, and more protection by the State is involved, in the case of income from saved money than in the case of earned money; and still more protection from the State is involved in the case of income from money that is inherited or received by gift, since the secure transfer of wealth by legacy or otherwise is one of the most obvious of the material benefits granted by stable government.

The ideal form of an income tax would thus be thrice differentiated, according to whether it was imposed on—

- (1) An income now being in the technical sense earned, that is a wage or salary or professional or business profits;
- (2) An income that is produced by savings made by its owner;
- (3) An income that is produced by inherited wealth or wealth received by gift.

If this triple differentiation could be made, then we should be able to do away with the death duties,

with the great unfairness that they involve, for example, when one estate changes hands frequently owing to the accident of death, and another escapes by being held for eighty or ninety years by a specially tough owner who happened to inherit it when an infant. If the death duties were thus commuted into the shape of a higher annual income tax on those who got income from inherited wealth, there would be a much greater chance, amounting almost to certainty, that they would be met by saving on the part of the holder of the income.

Thus differentiated, the ideal income tax would be graduated logically and steadily up to the highest range of incomes, not as it is now with a series of capricious jerks, and with the super-tax as an excrescence on the top. It would also be purged of the inequity which at present lumps together the income of husband and wife as one for assessment purposes, and of the still worse vice that it now possesses of taking little or no account of the children whom the taxpayer may have to educate. The unfairness of an income tax which is the same in the case of two brothers who each earn £1,000 a year, but one of whom has eight children and the other has none, is glaringly apparent, if we apply Adam Smith's test of ability to pay. Allowances for children were introduced during the Napoleonic war, but were given up in 1806, as they had "led to an astounding official increase of large families."¹ Mr. Lloyd George made a small beginning in his

¹ Seligman, *The Income Tax*, p. 103.

Budget of 1909 towards remedying this great blot on this tax by giving an abatement of £10 (from the income assessed) for each child under sixteen in the case of incomes under £500. Since then the amount of the abatement has been raised to £25 for each child, and this relief is given to incomes up to £700. Even so it is pitifully inadequate. The proposal made by Mr. Sidney Webb and his fellow-Fabians in their book on *How to Pay for the War* is much more efficacious, if it could be put into practice. They suggest that the basis of assessment in the case of families dependent on one income should be the income divided by the number of those dependent on it; that is to say, that if a man had £1,000 a year and a wife and eight children, he would be assessed on ten incomes of £100 each, and, as incomes of £100 each are at present exempt, he would be free of tax (but see note), while his bachelor brother would pay the full amount on his £1,000.¹

¹ The full text of the Fabian suggestion is as follows:

"What is suggested is that, so far as incomes not exceeding £2,500 a year are concerned, whether earned or unearned, it should be open to any person assessed to ask that all the taxable receipts of all the members of his family, living in the same household with him and sharing in its expenses, or maintained elsewhere wholly or partially at his expense, should be aggregated for assessment as a Family Income; and that Family Incomes so arrived at should, for income tax purposes, be divided by the number of members of the family (husband, wife, children, stepchildren, father and mother, or grandparents only) *actually maintained therefrom*. There could then be allowed from the combined Family Income, in respect of each person maintained therefrom, whatever Abatement each portion of such income would justify if it were that of one person only."—*How to Pay for the War*, pp. 237–8.

In order to prevent the suggested abatements and allowances

"But wait a minute," says the bachelor. "I don't quite see why I should be penalised for choosing, or perhaps being obliged by a hopeless passion, to live in single blessedness. If you let my brother off, it is clear that I shall have to be taxed higher. But why? He chooses to spend his income on the joys of bringing up a family and the delights of an uproarious nursery. Why should he therefore be let off while I, because I prefer keeping a yacht, and collecting blue china, and living a life of peace and comfort, or perhaps, if you knew all, giving up my spare cash to good works, am to pay more to encourage his philoprogenitive proceedings?"

The answer is obvious to all but confirmed bachelors, and it lies in the fact that the State wants citizens and wants them brought up under the best possible conditions. To penalize income-tax payers who are bringing up families, promotes that tendency to small families, or none, among the professional classes, which leaves the business of bringing up the heirs of the race to those who are least likely to give them the good air, good food, good clothes, and good teaching in their early years that are all-important to their efficiency when they are grown up. Economically and in every other respect, a nation can

from exempting too many people altogether from income tax, these writers suggest that "nothing in them should be allowed to reduce the tax actually payable below the minimum of, say, a penny in the pound on the income prior to the deduction of any abatement or allowance."

only thrive if it is composed of citizens sound in mind and body, and any taxation that makes the middle class sterile is a bad economic blunder.

And since we are only chasing the rainbow of the ideal, we may also add that, in order to make the income tax perfect, it would, though assessed on the whole income, only be imposed on that part of a man's income which he spends, and he would be allowed abatement in consideration of any part of it that he invested and not only, as now, on that part invested (within certain limits) in life insurance. This further exemption would be made, under an ideal system, because a State cannot make economic progress unless its citizens continually produce more than they consume on immediate enjoyment, so that there may be a margin of savings continually available for capital purposes, that is, for increasing future production by putting labour and energy into new equipment instead of into luxuries and amusements. This can only be done if we save, and it is therefore obvious that no tax can be called ideal which does not encourage investment. In time of war, however, this abatement might have to be modified.

An income tax adorned by the improvements above suggested would be so evidently equitable that it might be imposed on wage-earners' incomes considerably below the limit which it touches at present, and might be used for raising the greater part of the national revenue, however great the extent of the revenue required. There would be

no need then to talk about widening the basis of taxation, for taxation would be based on the widest possible foundation, the aggregate income of all citizens above the poverty line. Under ideal conditions it would be collected, no longer "at the source," but from the individual citizen, on his declaration of all the particulars required. It would not be payable by companies and firms, but only by their creditors, shareholders, and partners as they received interest due and profits distributed. Thereby all the evil effects on company finance that are now produced by the close watch that the Inland Revenue authorities keep on their interpretation of profit would be abolished. Any company or firm that preferred the strait path of good finance and took a generous view of the claims of depreciation and upkeep, would no longer be deterred by the consideration that it would have to pay income tax on some of the money that it was putting into the maintenance and improvement of its business. Moreover, companies with a large number of foreign shareholders, and whose profits are earned abroad, would no longer be impelled, as they are by the present high rate of income tax, to shift their seat of domicile to a foreign clime, because only that portion of their profits would be taxed which is paid into the pockets of British creditors and shareholders. So devised, taxation would not fall directly upon industry at all, but only on those who spent the proceeds of industry. We need not pretend that it would not affect and hamper in-

dustry, since all taxation must do so more or less ; but, I think, we can claim that it would do so less than any other.

Such a tax would meet and fulfil all the requirements laid down by Adam Smith or added to them by the light of modern experience. We should all know exactly what we were paying for the maintenance of the State ; graduation and differentiation would do all that can be done by human fallibility to make the tax work according to the ability of the taxpayer with due regard to the degree of protection that the State has to give to secure him the enjoyment of his revenue ; if the tax were payable in monthly instalments it would cause no inconvenience to the man with a small income ; every penny of it would go straight into the coffers of the State ; and the monthly collection of it would ensure a comparatively regular revenue against the nation's outlay.

How far is all this mere rainbow chasing and straining our eyes after an impossible ideal ? Not so far as it looks, perhaps, though the acceptance of such a tax in its entirety requires a degree of economic education and of common honesty in the community that we may not yet have attained. It has long been an argument against all schemes of graduation and differentiation of the income tax that we thereby lose the great hold over the would-be evader which is given to the tax-gatherer by collection at the source. And yet graduation and differentiation have been introduced without

any sign of loss to the revenue, and during the war the Treasury has gone a step further and issued a loan the interest on which, so far as it is held by registered or inscribed holders, is to be paid without deduction of the tax, the holder being left to include it in his own declaration of the extent of his liability.

The fact that if the income tax were worked on these lines everybody who was believed to be within its scope would be obliged to make a declaration of his income, would be a drawback in the eyes of those who still object to the "inquisitorial" requirement implied by it—that the State should know the details of everybody's income. This old-fashioned objection is, I think, out of date. As it is, the majority of income-tax payers have to declare details of their incomes, either in order to secure abatement, or differentiation, or for super-tax purposes. Seeing that the alleged "inquisition" is already applied to so many, there would be little or no hardship in clapping it on in all cases, as was actually done in 1798.¹ Like all the other suggestions made above, it is only a further development of a principle already recognized and acted on.

This is true even of the proposal, though it seems at first sight revolutionary, that the tax should only be imposed on that part of the income which is spent, instead of on what is earned. This principle

¹ "All persons being required to make returns of the whole of their income, from whatever source derived."—Chisholm's *Analysis*, p. 425.

is already recognized in the case of life insurance, and it is hard to see why it should not be applied to all other forms of thrift into which the taxpayer likes to put his savings. That income tax should be so imposed was urged, over half a century ago, by John Stuart Mill, and the suggestion also has the authority of Professor Pigou behind it, though he admits that there are technical difficulties to be overcome.¹ These difficulties are obvious enough, until the day comes when every citizen can be trusted to make an honest declaration, or when at least—as may be the case now—the general level of honesty is high enough to ensure that the amount of evasion by tax-cheaters would be small enough not to count. Such an arrangement would, of course, carry with it its contrary; if the tax were not imposed on the net amount invested, it would have to be imposed on the net amount of any investments realized in those years in which the taxpayer sold out more than he invested; because otherwise anyone could escape the tax by investing all his income in one year and selling the securities in the next. If the thing could be worked, its effect in cheapening capital, increasing the capital fund of the country, and so adding to its power to produce the good things of the earth, would be excellent, and it would be an equitable set-off to put against the high taxation now imposed on what is called “unearned” income. It might be possible to do it by means of evidence in the shape of stockbrokers’ contracts,

¹ *Wealth and Welfare*, p. 371, 2,

and evidence by solicitors in the case of investments in mortgages. The thing is not necessarily a pedantic aspiration on the part of academic dreamers, for I have heard it urged, not only as a good thing if it could be done, but as a good thing that could be done, by a very practical man of business; and if the ingenious experts of Somerset House were to decide that it was worth doing, they could probably devise the ways and means.

The suggestion that the income tax should be paid by the individual citizen and not by the companies which earn his income for him as shareholder may be criticized, apart from its parting from the principle of collecting at the source, as giving the power to companies to escape taxation by refraining from paying dividends and putting profits into improvement of their plant or into investments. This criticism falls to the ground at once if the principle is admitted that income tax should not be paid on saved money, because money that companies put into depreciation is saved money in every sense of the word. The economic progress of the community is helped by every pound that companies keep back from their shareholders and put into their plant or invest otherwise; and any encouragement that a fiscal system can give to this process has something to be said for it, though there may be countervailing drawbacks. If ever a time came when the productive capacity of the whole world were fully equipped and there were a real glut of capital, this need to encourage saving would

no longer exist. But we are not likely to see that happen just yet. There would, perhaps, be a danger that some companies might try to distribute profits by devious means—issues of bonus shares and so on—in order to enable their shareholders to escape taxation. But the keen blades of the Inland Revenue Department could very well be trusted to deal faithfully with any such buccaneering.

Still greater is the difficulty involved in making the range of the income tax run lower and embrace all the wage-earners who are a fit subject of taxation. In their case the precariousness of their earnings is much greater than in that of the salary-earner or even of the more precarious professional workers, such as the free-lance journalist. Moreover, they cannot, thanks to the education that has been given, or denied, them for many generations, be expected to keep count of their earnings with any regularity, and they would be likely to resent being pestered about them. It may take a long time before they are ready to recognize that an income tax applied more vigorously to wages would be fairer to them, if they would take the necessary trouble to tackle it, than the heavy charge of indirect taxation that they now bear. Economic education of all classes is the only way in which the path of the tax-gatherer can be made smooth and easy. The more this education grows, the faster will be the movement towards graduated and differentiated direct taxation as the fairest way by which the State can take our money.

It is sometimes said that the income tax punishes and fines the hard and successful worker. This is so, but what system of taxation does not? Whatever device you use, you can only tax those who are getting and spending money. But a system which taxes more lightly those who are earning than those who are getting interest on saved or inherited money, which makes due allowance for family liabilities and taxes what is spent and not what is saved, seems to give the hard and successful worker a better chance than most others.

When once the beauty and fairness of graduation and differentiation are seen and appreciated, it becomes clear that all indirect taxation is to a certain extent unfair, because graduation and differentiation cannot be applied to it. It might be possible, though very difficult, to graduate indirect taxation by increasing its rate according to the quantities of goods purchased; but this system, if applied to necessities of life, would evidently involve hardship by taking no account of the taxpayer's ability to pay. That the amount of taxation paid by the buyer of a pound of tea should be the same, whether the tea is to be consumed by one living on an inherited million, or by a widowed charwoman with five children and earning, with luck and when in good health, perhaps twenty shillings a week, is a gross fiscal blunder and a serious practical injustice. But there is no way round it, and this unfairness is necessarily attached

to all forms of indirect taxation. It is true that, as Adam Smith pointed out, taxes upon "such consumable goods as are articles of luxury can be avoided by the taxpayer, as he is at liberty either to buy or not to buy as he pleases." But so many things, such as clothes, are necessities up to a point, and become luxuries when that point, so difficult to decide on, has been passed, that taxing luxuries is not nearly as easy as it is desirable. And even in the case of admitted luxuries, such as alcoholic drink, the absence of graduation makes the tax unfair. Why should I, if I drink a glass of beer in the course of a country walk, pay no more taxation on it than a mechanic who partakes of a similar indulgence after working eight hours in front of a furnace? Ability to pay is quite different in these two cases, but the amount paid is the same. And yet this inequity attached to indirect taxation, that is so evident as soon as the principles of graduation and differentiation are admitted, has been so slowly recognized, and is still so much ignored, that it was once observed by the late Sir Robert Giffen that "on the whole an equal amount of indirect taxation causes perhaps only the half or the third of the privation and suffering entailed by an equal amount of direct taxation." Mr. Gladstone's ponderous joke, in which he compared the two forms of taxation to two attractive damsels, to both of whom, "whether it be due to a lax sense of moral obligation or not," he paid his addresses impartially, is well known to all students

of the subject,¹ and only shows how little the equities of taxation were studied in the days of that enlightened fiscal reformer.

Nevertheless, if it be a fact that direct taxation hurts while indirect does not, it is natural and inevitable that the practical politician who has to raise revenue for the State should prefer the latter. If we are really so stupid as to prefer to be bamboozled out of our money by paying, on a necessarily inequitable basis, for government, while we think we are paying for groceries or tobacco, instead of being assessed directly according to our ability and the source of our income and knowing exactly what we are paying, then we deserve what we get and get what we deserve, which is unfair taxation. In a democratic country in which all have political responsibility, it is clear that all, except those who have only the barest necessities of life, should pay taxes and so have some share in fiscal responsibilities. To do this in a manner which is specially designed to veil the fact that taxes are being paid, is hardly facing the problem squarely; but until education has gone far enough to make everybody ready to pay his fair share by means of direct taxation, it is the only way that can be hit on. The inequities connected with indirect taxes are manifold; not only can they not be graduated or differentiated, but it is impossible to impose them generally because taxes on the necessities of life are clearly bad, from the national point of view, in a community in which

¹ Seligman, *The Income Tax*, p. 163.

many people have not enough to eat. So that in days before the war anyone who escaped income tax and did not smoke or drink alcohol or tea contributed practically nothing to the Government under whose protection he or she lived. Since the war, taxes on cocoa, mineral waters, and entertainments have widened the fiscal net. The proportion of our revenue contributed by indirect taxation has steadily declined. In 1841-2 it was 73%; in 1912-13 it was 42·4%,¹ and during the war it is generally assumed to have declined still further, though it might be argued that the excess profits tax is an indirect tax, since most of it has been ultimately paid by consumers through the high prices that caused the excess profits.

Indirect taxation, being paid by those who buy certain articles for consumption, has one great advantage, which justifies its position in our fiscal system until such time as we are able to impose income tax only on that part of the income which is spent. It hits us when we spend and not when we earn or save. In time of war, when there is not enough labour and energy to do all that is needed for the fighting forces and for the export trade and for providing necessities, any tax that checks individual spending, or takes part of the sum spent for the Government, is clearly useful and beneficial. And this is almost equally true in time of peace, for then also wasteful spending is economically unsound, checks the material progress of the nation,

¹ *British Budgets*, by Sir B. Mallet, pp. 105 and 493.

makes the hard lot of the poor still harder, and lessens the demand for labour.¹ So that if only we could graduate and differentiate indirect taxation, it would have advantages over direct as the latter is at present imposed. As we cannot, it has to be left in its present unsatisfactory state, pressing heavily on the poorest consumers of such articles as tea, tobacco, and alcohol, while patriotic ladies who give 3,000 guineas for a fur coat in time of war pay no taxation in the process except the penny stamp on a cheque. A graduated invoice stamp on all retail purchases of 10s. and over is a way round this problem, but there are many practical difficulties in the way of it and if, as is likely, both shopkeepers and their customers united in resenting and detesting the tax, it is highly probable that there would be much evasion.

Of all forms of indirect taxation, the worst, according to the pure principles of taxation, are those imposed on imported goods of a kind that is produced in the country, unless a home tax (or excise duty) of the same amount is imposed on goods produced inland. Because the effect of the import duty is to raise the price of the article and, if the home producer is not similarly taxed, this means that part of the higher price will go into his pocket instead of into the coffers of the State. Nearly all nations, including our own colonies, make free use of this method of taxation, because they

¹ I have developed this platitude in a book called *Poverty and Waste*, published in 1913.

think it pays them in the long run, or think it necessary to the dignity or security of the State, that certain industries should be thus protected at the expense of the consumer. Some people think that when the war is over we also shall adopt the system of a protective tariff. We shall see. It is beyond the scope of this work to enter on this highly controversial ground. Everyone will admit that, if Protection is the only or the best means of keeping alive in the country an industry that is essential to national safety, then the most bigoted Free Trader must agree to it. It must also be admitted that many great, rich nations—including our richest enemy and our richest ally—have flourished under Protection. On the other hand, it warps and hampers trade, as a whole, and introduces an artificial complication into a matter which is naturally quite complicated enough; but perhaps the strongest argument against it is its tendency to make questions of taxation an unclean welter in which politics and business cover one another with dirt.

CHAPTER V

THE LIMITS OF GOVERNMENTAL SPENDING

So far we have considered the means by which the State takes our money from us for public purposes—

- (1) By borrowing it, and then taxing us to pay the lenders ;
- (2) By diminishing the buying power of our money by increasing its volume, with or without the help of bankers ;
- (2) By taxes.

There is yet another way by which some very clever people who have studied the question with great care and diligence think that the State might earn a great revenue, and that is by gathering money from us that we now pay to private undertakers of enterprise, and they believe that the State would do us a great benefit at the same time by giving us better service than these private undertakers. And many very earnest and high-minded people, who hate the waste and ugliness involved by the competitive system, have long believed that, if the work of growing, making, and distributing the goods

that we need were in the hands of the State, all the miserable squalor that blots our economic system might be washed away, man's labour would be made much more effective, and we should all of us, instead of wasting most of our lives in a chaotic struggle to earn our livings which ends in ill-spent affluence at the top with degraded destitution at the bottom, be free to live as civilized human beings; with time and energy to bring out all that is best in ourselves and others, and to enjoy the endless store of joy and beauty that Nature ever spreads before us, generally to be buried under the mass of moral and physical ugliness that is heaped over it by our misguided efforts to better our lot.

If these views are right, they have now a better chance than ever before of winning their way to action. War has shown us, first, how astonishingly great is our power to make and do things if we really want and mean to. Man has put all the prophets wrong who said that a great war could not last more than a few months, by proving that he could concentrate his energies on destruction with results that have appalled and astounded us, while at the same time producing all that was required for his material welfare; so much so that during the first two years of the war the general level of well-being in this country has been actually improved, owing to the more even distribution of the output, which was an economic incident of the war; so great was our margin of unused productive power and so great was the proportion of

our productive power that was put into turning out things that were not necessary to the nation's welfare. Secondly, the war has shown how short-sighted it is for a great and rich nation to allow a large part of its population to be stunted in mind and body. The voice of the social reformer is now raised in harmony with that of the recruiting sergeant, who wants sturdy men for the Army, of the employer, who wants strong and intelligent workers, and of the statesman, who wants a nation behind him every member of which can understand the tremendous issues for which we are fighting and see and act on the need for the measures taken to secure victory. Never has there been a time when it has been seen more clearly that a nation, to be strong, must be strong from top to bottom. In other words, the war has shown us how much we can do and how much needs to be done. But the question still remains, whether what needs to be done can be best done by the development of the individual's sense of national duty in work and spending, or by handing over to the State a continually growing share of the task of producing and distributing.

At a time when a brighter era is undoubtedly dawning for mankind, though it is only too possible that much turmoil and struggle may yet lie between us and its achievement, there seems to be something squalid in dwelling on the purely material side of the matter. After all, the human soul is the only thing that really counts. If everybody

were pleasant to live with, all other things would be added unto us ; if we were all honest and kindly and courteous and fair-minded and unselfish, there would be no need to fash ourselves about output and distribution, because we should all be doing our best to make things better, and all these sordid problems would solve themselves. But as things are, material considerations are of the greatest possible importance, because it is so much easier for the necessary qualities to be acquired by people who are not expected to spend most of their lives in trying to get a better share of the world's goods than their neighbours. If we can produce plenty for all and can prevent people from believing that getting more than plenty for themselves is the chief object of life, then there would be some chance for the rudimentary and atrophied human soul, which is now often treated very like the vermiform appendix—ignored if possible, and if not, cut out.

If, therefore, it is the fact that, by handing over great industries to be worked by the State for profit, we can make the State a great revenue earner, and at the same time do away with some of the competition that is a source of much waste and mendacity, without thereby producing a system of organized and hidebound efficiency that would kill all freedom and initiative, it is clear that we shall be relieving the taxpayer's burden and perhaps clearing a way towards a social system that will stand daylight better than our present one.

A great scheme of nationalization has been put before an interested public by Mr. Sidney Webb and his Fabian lieutenants, in a book, already referred to, called *How to Pay for the War*, published in 1916. They propose to increase very greatly the scope of the activities of the Post Office, making it do much of the work that is now done by bankers, and to nationalize the railways, the coal industry, and life insurance; and they urge, with a wealth of detail that is evidently the result of laborious investigation, that, if these things are done, the public will get a better and cheaper service, the workers employed will get better treatment, and the State will earn a revenue that will supply a mouth-filling number of millions for paying off the war debt. This attractive argument, of course, is only a development of the Socialist contention and an application of it to the needs of the moment; and for this reason will be refused a hearing by many to whom the mere name of Socialism is a terror. But a little later, as if to show how widely and in what unexpected quarters the idea of collectivist enterprise is being stimulated by our war problems, there arises a new portent in the economic sky in the shape of a body called the Empire Resources Development Committee, which also wants to help to pay off the war debt by means of State enterprise in industry and production, chiefly applied to overseas enterprise, though one of its manifestos also includes the coal and light and power industries at home among the means by which the after-war debt

charge can be met without anybody having to pay it; because the State will be able to do business so cleverly that it will find the money out of net profits. The really interesting thing about this Committee is that it bristles with names that have been hitherto renowned for Imperialist rather than for Socialist zeal, such as Mr. Rudyard Kipling, Sir Starr Jameson, Lord Grey (not the late Secretary for Foreign Affairs), Lord Selborne, Lord Desborough, and Mr. H. Wilson Fox, M.P., a distinguished officer of the Chartered Company of British South Africa; and with them is Mr. Vassar-Smith, the highly respected chairman of Lloyds Bank. That names such as these should be found on a manifesto advocating what one used to think was pure Socialism shows at least how people's minds have been shaken up by the war. The gist of their contention is that the immense latent resources of the Empire can be worked for State purposes and under State auspices in such a way that we shall be able to "lift from the peoples of the Empire the burdens caused by the war." And they, like Mr. Webb and his colleagues, think that the State can not only perform this financial feat, but at the same time cheapen the cost to consumers of articles that it provides and distributes.

It is a most alluring prospect and, if there is any chance of its being realized, the most bigoted Individualist will hardly let his dislike of State enterprise stand in its way. But is it not an enormous assumption to suppose that the State can

manage an enterprise with so much more success than a private undertaker that it can afford to buy him out, then provide a better service or a better article, pay everybody better, and finally make a thumping net revenue? In the case of new Imperial enterprises, there might be no one to be bought out, though vested interests sometimes are discovered in the most unlikely corners when a chance of compensation arises. The Imperial Development Committee expressly states that the proposed enterprises should not be managed by Civil Service Departments; but it does not explain how the managers can help becoming civil servants and so being involved with the attributes of those who work the State machine, so admirably within certain limits, but not so admirably when it is a matter of conducting business enterprise at a profit and with satisfaction to customers and employees. They make a profit out of the Post Office? Yes; but in discussing the tangled question whether what we pay for postal service should be considered as taxation or payment for services rendered, at least one distinguished economist has decided that postal revenue is taxation only in so far as we pay more for this service than we should if it were managed privately. Everyone agrees that it is impossible to gauge this amount, but no one seems to doubt that it exists, and that postal facilities would be cheaper if they were provided by private enterprise. Mr. Harold Cox, that stern, unbending foe of State enterprise, dealt faithfully with the proposals of

the Imperial Development Committee in an editorial in the *Edinburgh Review* for April 1917, and incidentally gave two examples of cases in which the State had taken over profitable enterprises and had totally failed to work them at a profit :

“ In 1870 the State acquired possession of the electric telegraph system of the country, which had been built up by various private companies. The purchase was recommended to the House of Commons as a splendid bargain for the State. The permanent officials who prepared the scheme assured the House that the whole of the capital cost would be repaid in fifteen years out of profits and that after that period there would be an ever-increasing revenue to relieve the burdens of the taxpayer. That was the promise. What actually happened was that the whole of the profit disappeared after the second year of working by the State ; that year by year the financial position has grown worse, till in the last years of peace the telegraphs were costing the taxpayer a sum which cannot be put at less than £1,400,000 per annum.

“ Meanwhile, the telephone had been invented. During many years the State, in order to protect its telegraph monopoly, did its utmost to stifle the development of the new invention. Finally, the State bought up the telephones, completing the purchase in the year 1911. Again there were prophecies—though in a somewhat minor key—of a lucrative bargain. These prophecies have gone the way of the old ones. The whole of the handsome tribute of over £350,000 a year, which the National Telephone Company was gratuitously paying to the

State, vanished at once, and within three years the income collected by the State barely covered outgoings."

With these actual examples before us we should hesitate before embarking on a large policy of State enterprise, especially if it is to be directed to the provision of necessities of life such as food and coal. Posts and telegraphs and telephones hardly touch the life of the very poorest, and though if they are bad and dear they are a hindrance and burden to business, their extra cost is a small item in the expense of industry; but it would be a different matter if the actual cost of living were raised through an attempt at revenue-earning by State enterprise in a country in which the test of experience has shown it to be dear and inefficient.

Nevertheless, we have no right to shut any door on a possibility of economic reform. We know that there are countries in which the State can manage some enterprises well and profitably, and even in England certain municipalities have earned good profits for their ratepayers and also served their customers well with comparatively simple businesses, such as tramway transport. It may be that Government departments, like the rest of us, have learnt much from the war and may now be able to tackle problems of enterprise with a new freedom and success. Strongly divergent views are expressed on this point, and no one who has not been in touch with the facts has any right to be sure about it.

Some say that the Munitions Department has been a miracle of official competence and success ; others that it was a costly chaos, only saved by the efforts of the business men, trained in the school of competitive enterprise, whom it called in to help it. But since there is a doubt and a new atmosphere, and since imaginative folk with big new ideas want to give us a lead, there seems to be no reason why they should not be allowed to try an experiment on a small scale, to be widened if the experiment succeeds. Freedom and individual initiative have so long been the life-blood of our national development that one is loth to see them encroached on even by the most efficient form of machine-made bureaucratic enterprise ; and the ideal of progress through the improvement of the individual, and a widening and deepening of his sense of national duty, seems to be a much higher and more hopeful one than through the expansion of State regulation to a point which implies the crippling of the soul of the citizen. Some of us hope that when the war is over we shall get rid of Government control as far and as fast as possible, except where previous experience had shown it to be necessary in the interests of the weaker parties to economic bargains.

“My experience [said Sir Alfred Booth to the Cunard Company’s shareholders in April 1917] of Government control has only served to convince me more firmly than ever that individual enterprise is the only spirit which can quicken the dead bodies

of capital and labour into life. . . . But I am not at all alarmed. When the war is over, commercial freedom will win in England just as political freedom has won in Russia, and we shall be quite content to leave the bureaucrats and the Romanoffs to cultivate their roses together in some suitable rural atmosphere."

But with taxation what it will have to be, all is fish that comes into the net, and if the State can learn to produce and distribute better and more profitably than private enterprise, no prejudice should stand in its way. But it ought to win its spurs, if it can, in a fair field and not with the support of privileges and monopolies and subsidies, still less with the help of tariffs.

Apart from this possible source of revenue, concerning which one is justified in doubting whether it will ever be realized and in feeling sure that in any case it will be slow in growth, taxation is the means by which the State will have to divert from our use so much of our annual output of stuff and work that has to be devoted to national purposes. As to the extent to which it can do this, there are conflicting opinions. Some say that, owing to the enormous weight of the after-war debt charge and our impoverishment by war, it will not, for years to come, be possible to find any money, that is divert any part of our output, to purposes of social improvement. On the other hand, there is the opinion, which the huge figures of our war spending have helped to stimulate, that now that we have learnt

to think in millions and in hundreds of millions, we shall never again be checked by any consideration of a few millions more or less in the cost of any reform that is accepted as needing to be done ; and that the reformer will henceforward have a bottomless purse to draw on since he will always, when the war is over, be able to say, " What I ask is only the cost of one day, or one week, or one month—as the case may be—of the late war, and just consider how much good it will do ! "

As to the first and pessimistic view, we cannot know how far it will be right until we know how much our capital equipment will have been impaired and how much we shall owe abroad by the time the war is over. If by the destruction of our ships and the depreciation of our industrial plant and of our soil's fertility, our output is seriously diminished, and if at the same time, owing to our borrowings abroad and sales of securities to foreigners, we shall have a much smaller sum to receive every year on balance from foreigners in interest, which comes to us in the form of imported goods ; then our total income, in the shape of goods produced by us and by our foreign debtors, will be less, and any part of it diverted to national needs will involve a greater sacrifice than before. In so far as it is held at home our debt involves no absorption of the national output, but only a transfer of part of it, by taxation, to the use of certain members of the nation who hold the debt. It is therefore only necessary to be sure that the taxation involved by it is imposed

on the people who ought to have subscribed to the loans. Then those who did their duty in subscribing will get their taxes back, those who pinched themselves and did more than their duty will get more than their taxes back, and those who did not do their duty will get nothing back, which is just as it should be. This arrangement is easier to describe as desirable than to put into practice, which is one of the objections to finance by borrowing.

But even if our total income, in goods produced by ourselves at home and by our debtors abroad, is materially less, which has yet to be proved, it does not follow that the amount of it available for national purposes will be less if we are resolved to make a greater sacrifice for them. Everything will depend on the temper and state of mind with which we set to work and turn out goods in the first place, and in the second, regard the claim on our work that the State may make for purposes of national development and improvement, such as health, education, housing, and the dozens of other things that, in the opinion of some of us, need to have work put into them. If we go to work in a bad temper and have strikes, lock-outs, and quarrels about methods of production and distribution of the output, then it is likely that our output will give us little chance of drawing on it for social reform. And there is also another enormous question to be answered. Shall we have to spend in future a much greater amount on defence, or will swords be hammered into plough-shares? The

hope, which was so strong in the early days of the war, of secure peace and freedom from the burden of armaments has lately looked sickly, but the intervention of the United States has certainly revived it, and it seems now at least possible that the League of Honour may ripen into a League of Peace that will rid mankind of war's nightmare.

These considerations apply also to the optimistic view which holds that we shall never again be stopped by lack of money. It is only true if the taxpayers are persuaded that the objects for which they are asked to make sacrifices are a national need and ought to be paid for out of the national purse. If a people makes up its mind that a thing is worth paying for, it can and will pay for it, up to the extent of half its income and more, as the war has shown. But this cannot be done if the burden of taxation is unfairly imposed, or if a considerable minority—especially if they are those who are asked to pay most—are opposed to the objects for which taxation is raised. "Taxing the rich" looks easy, but it cannot be done indefinitely unless the rich pay willingly. The taxpayer's power to strike, referred to in Chapter I, is still a real one. If the rate of taxation takes more from the producer and from the owner of accumulated or inherited wealth than they believe to be just, then the incentive to production and accumulation will be checked, and the tree which bears the plums will have been killed, or weakened in its fruitfulness. For national defence everyone is ready to have his money taken,

and in war-time there is much less tendency than usual to grumble about the manner in which the money is raised. For national improvement and for what Mr. Lloyd George once called a "War Budget against poverty and squalidness" there may some day be the same cheerfulness and readiness on the part of those who pay. It may be that war will have taught them this lesson. If so, in spite of all its horrors, the war will have opened the way to a great stride forward along the road of progress. But there are no short cuts on this road, and only by the education of the individual to a just view of his duty as a producer and worker, and of the claim of the State upon his product for national needs, can full use be made of our wealth for purposes worthy of a nation that has always been a leader in human progress.

INDEX

- BANK OF ENGLAND as currency maker, 61 *seq.*
- BANKS as currency makers, 64 *seq.*
- BASTABLE, PROF., on State's claim, 3
- BOOTH, SIR A., on State control, 114
- BORROWING ABROAD, effects of, 50 *seq.*
- BORROWING AT HOME :
 - advantages of, 38, 41, 43
 - evils resulting from, 42 *seq.*, 47 *seq.*
- CAPITAL, objections to taxing, 87
- CHILDREN, abatements for, 89 *seq.*
- CONSOLS carry no claim to repayment, 28
- COX, HAROLD, on State enterprise, 112
- DEATH DUTIES** imply differentiation, 86
- DIFFERENTIATION of income tax, 85
- EDUCATION, public spending on, 10, 21 *seq.*
- EMPIRE RESOURCES DEVELOPMENT, as revenue earner, 109
- FOXWELL, PROF., on inflation, 54
- GIFFEN, SIR R., on indirect taxation, 100
- GLADSTONE, MR., on forms of taxation, 100
- GRADUATION :
 - applied to income tax, 82 *seq.*
 - impossible in indirect taxation, 99
- GUERNSEY MARKET, miracle of, 57
- HUME, JOSEPH, on taxes as confiscation, 6
- HUXLEY on State interference, 15
- INCOME TAX :
 - advantages of, 82 *seq.*
 - ideal form of, 88 *seq.*
- INDIRECT TAXATION :
 - advantage of, 102
 - decline in, 102
 - unfairness of, 99 *seq.*
- INFLATION :
 - effects of 68
 - meaning of, 55, 58
 - methods of, 60
- IMPORT DUTIES, objections to, 103, 104
- JAMES I borrows without interest, 27
- JOHNSON, DR., on currency, 55
- LAISSER-FAIRE :
 - domination of, 18
 - results of, 19
- LIBERTY, Abraham Lincoln on, 20
- LOCKE on government, 2
- LUXURIES, difficulty of taxing, 100
- MILL, J. S., advocates exemption of savings, 96
- PATRIOTISM and taxation, 7
- PIGOU, PROF. :
 - advocates exemption of savings, 96
 - on inflation, 67

- POLL TAX, graduated, 84
- POSTERITY :
 how our spending affects it, 35
 will not pay our debts, 30 *seq.*
- PRIVY SEAL, letters of, 27
- PROPERTY, protection of, 1
- ROMAN EMPIRE drives taxpayers
 to strike, 5
- SINKING FUND, how provided, 34
- SMITH, ADAM :
 on governmental spending, 20
 seq.
 on taxation, 76 *seq.*
- SPENCER, HERBERT, on State
 action, 9 *seq.*
- STATE ENTERPRISE as revenue
 earner, 105 *seq.*
- STRIKE, taxpayers' power to, 5
- TAXATION, advantages of, in war,
 44 *seq.*
- TREASURY NOTES :
 amount of, 65
 issue of, 53
- WAGE EARNERS and income tax,
 98
- WALKER, F. A., on Smith's
 maxims, 77 *seq.*
- WEBB, SIDNEY :
 on family incomes, 90
 on State enterprise, 109

